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Supreme Court of the United States

OCTOBER TERM 1940

No. 1048 84

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN,

Petitioners,

against

AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act,

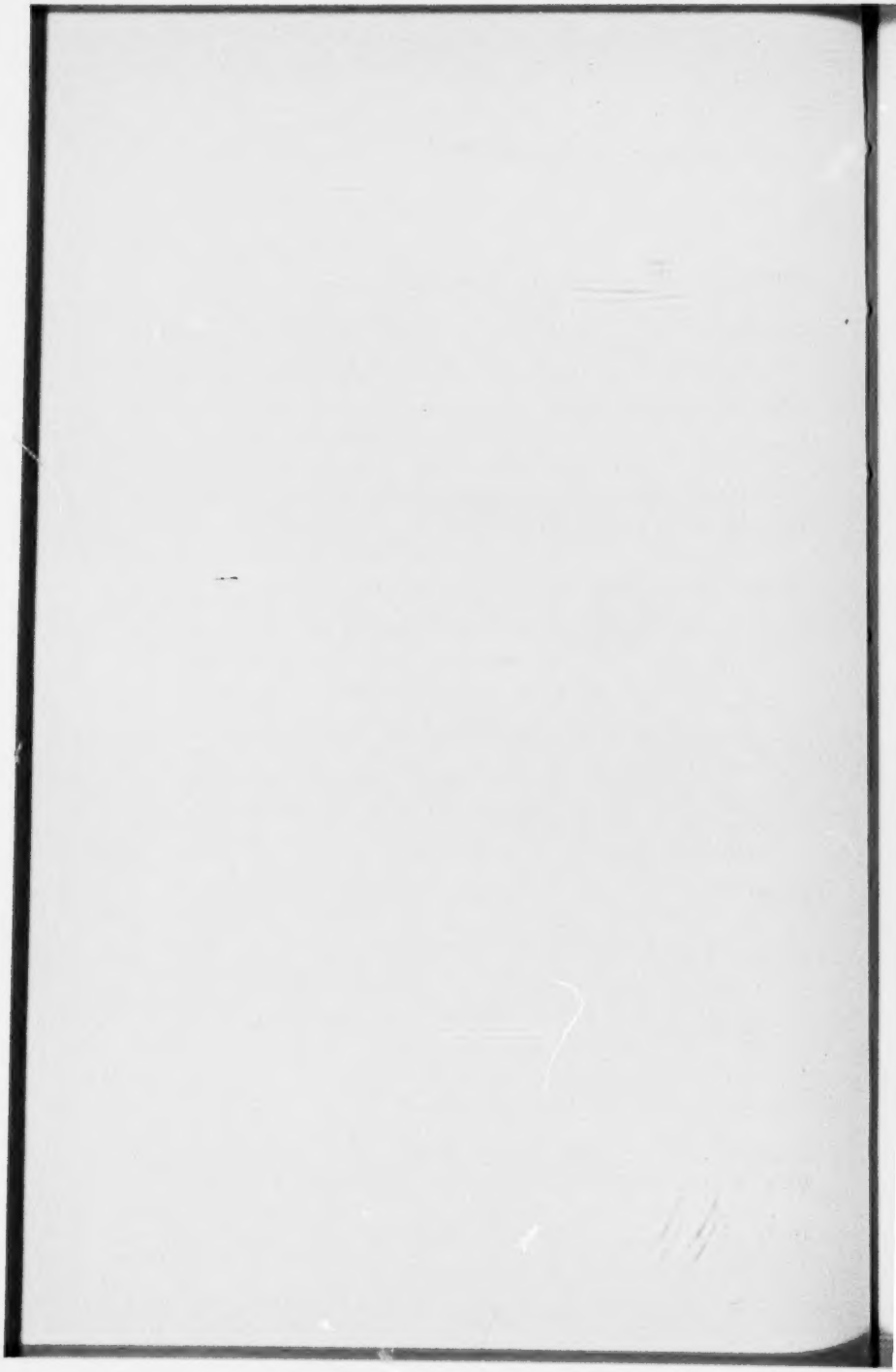
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

RAYMOND J. SCULLY,
Counsel for Petitioners, Sargent & Co. *et al.*

HILBERT I. TRACHMAN,
Counsel for Petitioner, Anna L. Linahan.

Press of Fremont Payne, Inc.



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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners respectfully show as follows:

Statement

This is an application for a writ of certiorari to review a decree of the United States Circuit Court of Appeals for the Second Circuit, entered on February 14, 1941 (Tr. 725) insofar as that decree reverses the order and judgment made on May 18, 1940, by Honorable Alfred C. Coxe,

United States District Judge for the Southern District of N. Y. (Tr. 65 et seq.) and grants leave to the debtor, through a new board of directors, to withdraw its consent to reorganization by filing a new Answer. The said order and judgment of Honorable Alfred C. Coxe (Tr. 65-67) approved the Findings of Fact and Conclusions of Law and the Report of the Special Master of April 26, 1940 (Tr. 68-89), and approved the petition of the creditors together with the written consent of the debtor as having been properly filed under Chapter X of the Bankruptcy Act.

Opinions Below

The opinion of the Circuit Court sought to be reviewed, dated January 27, 1941, is reported in 117 Fed. (2d) 140 and is printed in full on pages 718 to 724 of the transcript of record herein.

Basis for Jurisdiction

The jurisdiction of this Court is invoked under Section 240-A of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; 28 U. S. C. A. Sec. 347(a)).

Questions Involved

I. May a debtor which has invoked the jurisdiction of the Federal Court by filing, prior to approval of an involuntary petition, a written admission of its inability to meet its debts as they mature, a consent to reorganization under Chapter X, and a request for approval of the Chapter X petition, defeat such jurisdiction by withdrawing such consent under the guise of filing an amended answer, although it appears after trial that the debtor requires reorganization under Chapter X?

II. Do the provisions of Sections 126 and 142 of Chapter X of the Bankruptcy Act prohibit a debtor from expediting the proceeding by consenting to reorganization and requesting the approval of an involuntary petition?

III. Does the creditors' petition in conjunction with the debtor's written admission of its inability to meet its debts as they mature, its consent to reorganization under Chapter X, and its request for approval of the Chapter X petition, satisfy the requirements of Secs. 130 and 131 of the Bankruptcy Act?

IV. Was the Circuit Court required by Rule 15(a) of the Federal Rules of Civil Procedure to permit the debtor to withdraw as a matter of right its written consent to reorganization under Chapter X and its request for approval of the Chapter X petition upon the basis of which the District Court had assumed jurisdiction?

V. Do the directors of a corporation in financial distress require the approval of the majority stockholders in order to consent to the jurisdiction of a court for a reorganization proceeding?

Summary Statement

This is a proceeding for the reorganization of J. P. Linahan, Inc., the debtor, under Chapter X of the Bankruptcy Act, instituted by the filing of a creditors' petition on February 20, 1940. The debtor and minority stockholders consented to the creditors' petition. The majority stockholders contested it. After a trial before a Special Master the petition was approved as properly filed under Chapter X. All claims against the estate of the debtor have been filed, and proposed plans of reorganization have been submitted by both sides to this controversy.

It should be stated at the outset that this is not a case where any party is resisting the reorganization of the debtor. All parties agreed: (a) that the debtor is unable to meet its debts as they mature; and (b) that the affairs of the debtor require reorganization under the Chandler Act.

The fundamental controversy in the District Court and in the Circuit Court has been whether the reorganization shall proceed under Chapter X or Chapter XI. The Special Master has found that adequate relief could not be obtained under Chapter XI and that the proceeding should continue under Chapter X (Tr. 82, 85, 86). This finding was confirmed by the District Court (Tr. 65-67) and has not been disturbed by the Circuit Court (Tr. 724).

The Circuit Court, sacrificing substance for form (Tr. 724), almost one year after the filing and approval of the petition, reversed the decree of the District Court approving it, on the ground that the debtor's consent and prayer for the approval of the creditors' petition could not convert the proceeding into a voluntary one and that therefore it was necessary for the creditors to prove the commission of an act of bankruptcy by the debtor. It also permitted the debtor through a new board of directors selected by the majority stockholders, to file a new answer which would withdraw its consent and which would place in issue the commission of an act of bankruptcy. The Circuit Court ruling turned primarily upon literal constructions of several Sections of Chapter X which it erroneously interpreted in violation of the intent of the Act and in disregard of the functional aspects and practical administration of the Act.

The pertinent facts in chronological order are as follows:

J. P. Linahan, Inc., hereinafter referred to as the "debtor", for sixteen years has been engaged in the manufacture and sale of caskets and funeral supplies in the City of New York. At the commencement of the proceeding

its book assets were $416,198.76 and its liabilities $233,-909.24 (Tr. 13), 2,951 shares of its stock were outstanding: 1,800 owned by Agatha L. Moore and her designees, referred to throughout as "majority stockholders"; 750 shares owned by Anna Louise Linahan, individually and as Executrix of the Estate of James P. Linahan, deceased (the founder of the company), referred to throughout as "minority stockholders"; and 401 shares owned by officers, directors and employees of the company (Tr. 73, 74). Neither the majority nor minority stock interests have been connected with the operation of the business. The management was confined to the directors, officers and employees, who with two exceptions have served for many years (Tr. 74-77).

Unable to pay its debts as they matured, the debtor, through its officers, held a series of conferences with the attorneys for the majority and minority stockholders and with the creditors and their attorneys, which commenced in January, 1940. The majority stockholders repeatedly represented the stock of the debtor to be worthless and offered to pay creditors 40 cents on the dollar or to take the same percentage for their own claims and to "throw in" the stock of the debtor held by them (Tr. 75, 451, 452, 457, 459, 460, 551). When this offer was rejected, the majority stockholders sought, unsuccessfully, to have the directors and officers of the debtor file a Chapter XI petition proposing a payment to creditors of 20% in full for their claims (Tr. 76, 548, 552, 553).

Although all parties recognized the need for reorganization, an agreement could not be reached and on February 14, 1940, in the presence of all parties or their attorneys, the creditors appointed a Committee and instructed counsel to file a petition under Chapter X (Tr. 500). Such a petition was filed on February 20, 1940 (Tr. 5-18). The officers of the debtor, the following day called a meeting of the board of directors of the debtor (which board had constituted the management of the debtor for many years) (Tr. 15,

78). At this meeting a resolution was unanimously adopted which declared the debtor's inability to pay its debts as they matured; its willingness to be reorganized under Chapter X; its request that the creditors' petition be immediately approved; and directing the execution and filing of an answer to the creditors' petition containing the foregoing admissions and consent (Tr. 13, 15, 16, 17). Such an answer and consent (Tr. 13-17) together with a certified copy of the resolution of the board of directors (Tr. 18 to 19) and an affidavit of Lester S. Berry (Tr. 34-37), the President of the debtor, was filed. Whereupon, Honorable Alfred C. Coxe, District Judge, assumed jurisdiction of the proceeding and made an order based specifically upon both the creditors' petition and the debtor's answer and consent, approving the petition for reorganization as properly filed under Chapter X and continuing the debtor in possession (Tr. 37).

On February 26, 1940, Agatha L. Moore, one of the majority stockholders, filed an answer as a creditor (Tr. 20-22). On March 26, 1940, the majority stockholders filed an answer on their own behalf and derivatively on behalf of the debtor (Tr. 23-31). By these answers, the majority stockholders admitted that the debtor could not pay its debts as they matured, but contended that no act of bankruptcy had been committed, that the consent of the debtor was fraudulently filed by its board of directors, and that adequate relief could be obtained under Chapter XI. On March 8, 1940, Anna Louise Linahan, one of the minority stockholders, filed an answer similar to that of the debtor and prayed for relief under the provisions of Chapter X (Tr. 31-33).

The issues raised by the pleadings were fully tried before Special Master Peter B. Olney, Jr., who decided them adversely to the majority stockholders (decision, Tr. 604-610) and recommended the approval of the creditors' petition and the debtor's answer and consent as having been properly filed under the provisions of Chapter X. His find-

ings made on April 26, 1940 (Tr. 68-89), were confirmed by the District Court (Tr. 65-67) and were not disturbed or over-ruled by the Circuit Court, except for one conclusion of law (opinion, Tr. 718 et seq.).

Amongst other findings, it was held that adequate relief could not be obtained under Chapter XI and that Chapter X was the appropriate one for this proceeding (Tr. 82, 85, 86) and that the board of directors was not guilty of fraud in filing a consent to a Chapter X proceeding (Tr. 82, 83, 84).

The District Court also held as a matter of law that by the filing of the consent of the debtor, requesting approval of the Chapter X petition the commission by the debtor of an act of bankruptcy became immaterial to the issues and that the proceeding in effect became a voluntary one. In so holding the District Court relied upon *In Re Palisades-on-the-Desplaines,* 89 Fed. 2d 214, C. C. A. 7th; *In Re Park Beach Hotel Building Corp.,* 96 Fed. 2d 886, C. C. A. 7th (cert. denied 59 Sup. Ct. 105, 305 U. S. 638 mem.); and *In Re Snyder* v. *Fenner,* 101 Fed. 2d 736, C. C. A. 3rd.

The Circuit Court for the Second Circuit expressly disagreed with the above decisions of the Seventh and Third Circuits and reversed the order of May 18, 1940, which approved the petition as properly filed under Chapter X.

The Circuit Court also granted leave to the debtor, through a new board of directors, to file a new answer and thus withdraw the consent to reorganization upon which the approval order was in part based. The facts relating thereto are as follows: The annual meeting of the stockholders of the debtor was originally fixed for a date in September, 1939, but due to the indifference of the stockholders and their failure to attend, it had been adjourned from time to time to February 14, 1940 (Exhibit 4 not printed at length; see Tr. 714) and again adjourned to February 24, 1940 (Tr. 560, 561). This meeting was thereafter adjourned to March 2, 1940. On February 28, 1940, the majority stockholders

applied to the District Court for leave to elect new directors (Tr. 705). The Special Master denied the application on March 20, 1941. On appeal, the Circuit Court reversed the order on May 6, 1940 (*In Re J. P. Linahan, Inc.*, 111 Fed. 2d 590).

On June 5, 1940, the majority stockholders' new board of directors sought leave to file a new answer on behalf of the debtor (Tr. 230-261). This application was addressed to the court's discretion and not sought as a matter of right. The proposed answer (Tr. 248-261) of the new board, although admitting the inability of the debtor to pay its debts as they mature and its need for reorganization, alleged that the action of the old board in consenting to the Chapter X proceeding was fraudulent and that adequate relief could be obtained in Chapter XI, both of which issues had already been determined otherwise by the District Court after trial of similar issues raised by the answers of the majority stockholders.

The application to file a new answer was denied by the District Court (opinion of Special Master, Tr. 282-290; order of District Court Tr. 228-229). The Circuit Court dismissed the appeal from this order as moot (Tr. 725), but granted leave to file a new answer as a matter of right. The grounds upon which the Circuit Court reached this conclusion were: that the majority stockholders should normally have their way and the board of directors should not commit the debtor to a course of conduct not approved by the majority stockholders, and that the debtor could have filed within twenty days an amended answer as a matter of right under Rule 15(a) of the Federal Rules of Civil Procedure, had not the District Court enjoined the election of a new board of directors.

On the first ground, the Circuit Court, though recognizing that directors who exercise their honest judgment are "immune from the control of their shareholders", reached a decision in conflict with the decisions of the

Court of Appeals of the State of New York and of this Court. The second ground, i. e., the filing of the answer as a matter of right, was a conclusion reached by the Circuit Court as one "impossible to avoid."

Reasons Relied on for the Allowance of the Writ

1. The Circuit Court of Appeals for the Second Circuit has decided erroneously, petitioners respectfully submit, questions of public importance which are vital to the proper administration of Chapter X of the Bankruptcy Act and which fundamentally affect the functional application of Chapter X. These questions have not been, but should be settled by this Court. The questions presented require a construction of Sections 126, 130, 131, 136, 137, 142 and 161 of Chapter X and Rule 15(a) of the Federal Rules of Civil Procedure. A decision in this case will determine the application of the Act and Rules in many other cases.

2. The decision of the Circuit Court of Appeals for the Second Circuit is in direct conflict with the decisions of the Seventh Circuit, *In Re Palisades on the Desplaines,* 89 Fed. 2d 214, and *In Re Park Beach Hotel Building Corp.,* 96 Fed. 2d 886, and with the decision of the Third Circuit, *In Re Snyder* v. *Fenner,* 101 Fed. 2d 736, and with the decision of this Court in *Securities & Exchange Commission* v. *United States Realty Improvement Co.,* 60 Sup. Ct. 1044, 1053, 310 U. S. 434, 451, 455.

3. The decision of the Circuit Court of Appeals for the Second Circuit conflicts with the decisions of this Court in *Royal Indemnity Co.* v. *American Bond & Mortgage Co.,* 289 U. S. 165, 53 Sup. Ct. 551, and the decisions of the Court of Appeals of the State of New York in *Rogers* v. *Pell,* 154 N. Y. 518, 527; *Young* v. *Stone,* 61 App. Div. 364, 70 N. Y. Supp. 558, affirmed: 174 N. Y. 517, 66 N. E. 1118,

and *Manise* v. *Powell,* 201 N. Y. 194, on the issue of the rights of majority stockholders and their control over the board of directors.

WHEREFORE, the petitioners respectfully pray that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Second Circuit, commanding that court to certify and to send to this Court for its review and determination on a day certain to be therein named, a transcript of the records and proceedings herein, and that the order of said court entered on February 14, 1941, reversing the judgment and decree of the District Court for the Southern District of New York of May 18, 1940, and granting the debtor leave to file a new answer, be reversed by this Honorable Court, and that petitioners have such other and further relief in the premises as to this Honorable Court may seem just and equitable.

Dated, May 3rd, 1941.

RAYMOND J. SCULLY,
Counsel for Petitioners, Sargent
& Company, *et al.*

HILBERT I. TRACHMAN,
Counsel for Petitioner,
Anna Louise Linahan.

State of New York,
City of New York,
County of New York, } ss.:

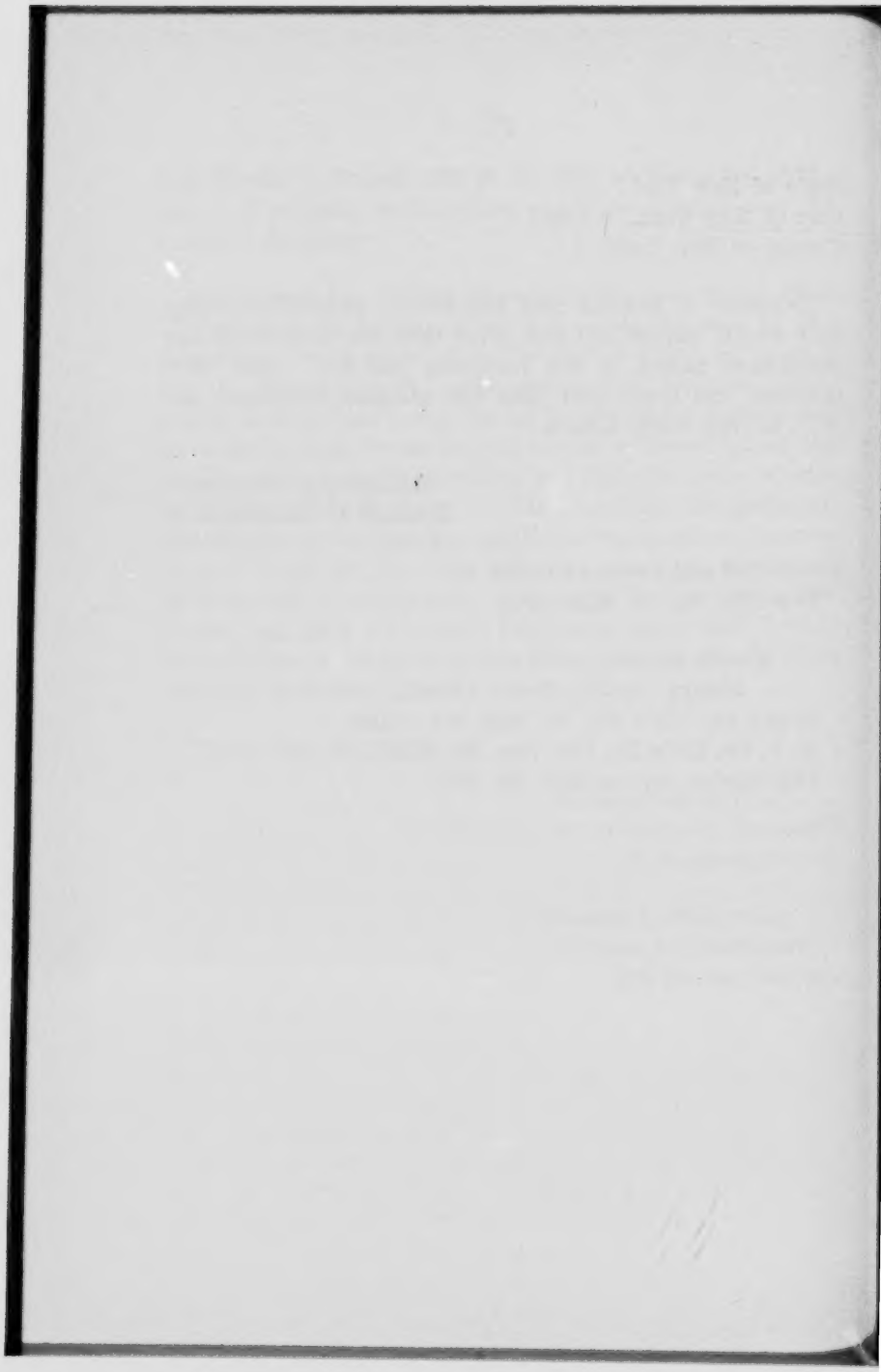
RAYMOND J. SCULLY and HILBERT I. TRACHMAN, being duly sworn, depose and say: That they are counsel for the petitioners named in the foregoing petition. That they prepared the same, and that the allegations thereof are true, as they verily believe.

RAYMOND J. SCULLY,
HILBERT I. TRACHMAN.

Subscribed and sworn to before me
this 12th day of May, 1941.

CLAIRE LESSER,
Notary Public, Bronx County,
Bronx Co. Clk's No. 36, Reg. No. 94L43.
N. Y. Co. Clk's No. 591, Reg. No. 3L367.
Commission expires Mar. 30, 1943.

CL.



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Respondents.

BRIEF IN SUPPORT OF PETITION

POINT I

The Circuit Court of Appeals for the Second Circuit erroneously interpreted and applied the provisions of Chapter X of the Bankruptcy Act, and its decision is in direct conflict with the decisions of the Seventh and Third Circuits, and of this Court.

It has been pointed out in the foregoing petition that all parties admit the inability of the debtor to meet its debts and the need of reorganization under the Chandler Act. The District Court after trial has determined that adequate relief cannot be obtained in Chapter XI and that Chapter X

is the proper vehicle for reorganization. Far from disturbing these findings, the Circuit Court appears to recognize their validity when it suggests in its opinion that its decision unavoidably turns "upon a question of form rather than substance" (Tr. 724).

What, then, is the question of form upon which the decision of the Circuit Court turns and by reason of which it feels constrained to vitiate a reorganization which is in its final stages after more than a year of effort? It concerns the effect to be given to the answer and consent of the debtor.

Under the provisions of Chapter X, a creditors' petition is required to contain, in addition to the necessary allegations of a debtor's petition (Sec. 130), any one of the five statements set forth in Sec. 131. The petition filed herein contained the fifth of these, namely: "that the corporation has committed an act of bankruptcy within four months before the filing of the petition" (Tr. 8).

Upon the trial of the issues, the petitioning-creditors offered no proof of an act of bankruptcy. The creditors contended that the legal effect of the debtor's answer was the same as if the debtor had filed a voluntary petition in the first instance, in which event no allegation or proof of an act of bankruptcy would have been required (Sec. 130), and that, therefore, the question of an act of bankruptcy was no longer material.

The Circuit Court in construing the effect of the debtor's answer recognizes that the petition and answer and consent taken together complied in all respects with the requirements of Section 130 of the Act, for its says in its opinion:

> "It is indeed true, if we take the petition and answer together, that enough can be spelled out to satisfy the requirements of Sec. 130. The answer itself declares that the debtor is "unable to pay its debts as they mature", and not only consents to the approval of the petition, but prays that it should be approved; the other necessary facts it admits by not denying them.

Rule 8(d). Thus the debtor has expressly or impliedly made all the declarations that it need have made if it had filed a petition" (Tr. 720).

Nevertheless the Circuit Court held that the answer of the debtor did not have the effect of converting the proceeding into a voluntary one. In so deciding, it recognizes that it is going contrary to the decisions of two other Circuits, for it says:

> "Two circuits decided—one of them twice—that an answer in an involuntary proceeding which alleged all the facts necessary to a voluntary petition could be treated as a voluntary petition. *In Re Palisades-on-the-Desplaines,* 89 Fed. (2) 214 (C. C. A. 7); *In Re Park Beach Hotel Bldg.,* 96 Fed. (2) 886 (C. C. A. 7); *Snyder* v. *Fenner,* 101 Fed. (2) 736 (C. C. A. 3)" (Tr. 720).

In each of these decisions it was held that the debtor's answer consenting to an involuntary petition made unnecessary any proof of an act of bankruptcy. The opinion of the Seventh Circuit in *In re Palisades-on-the-Desplaines,* 89 Fed. (2d) 214-216, is so appropriate to the issues here involved that we quote from it at some length:

> "Appellant is the only objector to the decree of confirmation. He first contends that the court was without jurisdiction to consider the involuntary petition because of the absence of the allegation that the debtor had committed an act of bankruptcy within four months prior to its filing.
>
> We think there is no merit in this contention. Of course, the creditors' petition, standing alone, was defective, and for the reason urged by appellant it was not sufficient to give the court jurisdiction of the subject matter. However, before the court approved it, the debtor had filed its answer admitting the jurisdiction of the subject matter and the several allegations of the petition, and specifically averring its inability to meet its debts as they matured. Thereupon, the court entered its order of approval in which it used

the following language: 'Upon due consideration of the petition * * * and the answer of the debtor * * * stating that said debtor is unable to meet its debts as they mature and that it desires to effect a plan of reorganization in accordance with section 77B * * * and the court being satisfied that said petition complies with the said section and that it sets out facts showing need for relief, and that it has been filed in good faith, it is ordered. * * * "

(1) The facts here recited, in effect, made the proceeding a voluntary one and gave the court jurisdiction of the subject matter and the parties.

Subsection (a) of section 77B (11 U. S. C. A. Sec. 207(a) provides: '* * * If such answer shall admit (a) the jurisdiction of the court, and (b) the material allegations of the petition, the court shall enter an order approving the petition as properly filed under this section if satisfied that it complies with this section and has been filed in good faith.' The answer not only admitted jurisdiction, but it specifically admitted the facts which concededly gave the court jurisdiction of a voluntary petition. The words 'this section', just quoted, refer to section 77B, which sets forth the requirements of both a voluntary petition of the debtor and an involuntary petition of creditors.

(2) Construing all pertinent parts of the section together, we interpret the requirements of the involuntary petition, such as we have here, to mean that it shall contain the allegation of an act of bankruptcy within four months prior to its filing, or an admission by answer of the debtor that it is unable to meet its maturing debts. In such event, under that part of the section which we have quoted, it was obviously the duty of the court to approve the petition as properly filed under this section. This it did, and there was no error in so doing. Reason, we think, supports this conclusion. The debtor's verified answer avers facts sufficient to authorize the approval of a voluntary petition, and the court was warranted in so treating it. Whether it considered it as such, or regarded the creditors' petition, aided by the answer, as sufficient, is imma-

terial. Both are permissible under the statute, as we construe it, and either would carry out its plain intention. It is urged, however, that the court did not specifically approve the answer. That part of the section which we have quoted does not require that the court specifically approve the answer, but that it did consider its allegations, and approve, and rely upon them is quite manifest from the recitals of the decree.

(3) Certain authorities upon which appellant relies have been cited to the effect that jurisdiction can not be conferred by mere admission. As a general rule, that is true but that rule applies to cases where jurisdiction is inherently lacking. Here, however, the District Court was the only one which could have jurisdiction of the subject matter, and only upon conditions which depended entirely upon allegations of fact. The only one lacking was furnished by the debtor's admission, which it had a right to make, and under such circumstances we think jurisdiction was thereby conferred."

A similar conclusion was reached by the Seventh Circuit in *Park Beach Hotel Bldg. Corporation,* 96 Fed. (2d) 886 (cert. denied: 59 Sup. Ct. 105, 305 U. S. 638 mem.), (Supra), wherein an involuntary petition for reorganization was attacked by a creditor because it omitted to allege an act of bankruptcy. The Court said (page 891):

"Furthermore, the answer of the debtor, consenting to the jurisdiction and agreeing that there should be a reorganization, removed any possible error, for a corporation may become a voluntary petitioner for relief either by an answer to pending involuntary proceedings or by original petition. Section 77B of the Bankruptcy Act."

The Third Circuit, in *Snyder* v. *Fenner,* 101 Fed. (2d) 736 (Supra), agreed with the Seventh Circuit. It said, (page 738):

"Furthermore the debtor filed an answer admitting the allegations of the petition and joining in its prayers.

> This the debtor had a right to do even though a receiver was in possession of its property. *In re C. Moench & Sons Co.*, 2 Cir., 130 F. 685; *Struthers Furnace Co.* v. *Grant*, 6 Cir., 30 F. 2d 576. The effect of its answer was to convert the proceeding into a voluntary one and thus to remove from the case the questions as to the petitioning creditors' status and as to the debtor's solvency. *In re Palisades-on-the-Desplaines*, 7 Cir., 89 F. 2d 214; *In re Park Beach Hotel Bldg. Corp.*, 7 Cir., 96 F. 2d 886."

In rephrasing the provisions of Section 77-B, it was not intended to alter or change the rule stated above. This is evident from the statement which appears in the "Analysis of the House of Representatives' Bill of 12889" (The Chandler Act), 74th Congress, 2d Session, used by the Committee on the Judiciary. Commenting on Section 142 of Chapter X (pp. 64-65) of Analysis, the following statement is found:

> "The essentials of this provision are derived from 77B a. We have made some changes in language and have re-ordered and expanded the provisions for the sake of inclusiveness, clarity, and directness of statement." * * *
>
> "We have also discarded the provision which declares that, upon the approval of a creditors' petition, the proceedings shall continue as if the corporation had itself filed the petition. This would necessarily follow, and need not be spelled out."

See also, Jacob I. Weinstein's "The Bankruptcy Law of 1938, where at page 209 Mr. Weinstein, a member of the Drafting Committee, says in discussing Section 142:

> "It may here be noted that the clause of subdivision a of sec. 77B which provided that, upon the approval of the creditors' petition, the proceedings should continue as if the debtor had filed the petition, has been deleted. Under the revised structure of the Chandler Act, that express statement became unnecessary."

As in the cases above cited, the District Court in the instant proceeding likewise assumed jurisdiction upon the written consent and request of the debtor, and specifically based its approval order thereon, as well as on the creditors' petition (Tr. 37-43). Indeed the order recites that it is made on motion of the debtor's attorney (Tr. 38).

It has been stated that the additional allegations in a creditors petition required by Section 131 were enacted solely for the protection of a debtor from "aggressive and ill-timed actions by its creditors". Finletter, The Law of Bankruptcy Reorganization, page 38. The Second Circuit also holds this to be true, for it has said:

> "The first four of these five alternate allegations are in substance that the debtor's estate is already in process of some kind of administration; they are necessary only as a protection to the debtor, since they show that its business has already succumbed to legal custody. The fifth—an act of bankruptcy—is even more clearly for its protection" (Tr. 722).

Where, as in the instant case, a debtor joins with its creditors and seeks needed relief under Chapter X, the debtor obviously can waive those provisions which were included in Section 131 for its protection, since proof of the existence of any one of the five statements contained in that section is not necessary to confer jurisdiction on the Court.

The jurisdiction of the District Court did not depend upon the commission of an act of bankruptcy by the debtor. The Court had inherent jurisdiction of the subject matter and of the debtor, and all "other requisities to the jurisdiction" existed.

In Re Reisenberg, 208 U. S. 90, 28 Sup. Ct. 219.

The Second Circuit in discussing creditors' petitions in bankruptcy proceedings has heretofore held that the allegation and proof of an act of bankruptcy may be waived.

In Re S. W. Strauss & Co., 67 Fed. (2d) 605, 609; *Bradley* v. *Huntington*, 277 Fed. 948.

The Seventh Circuit has also so held *In Re Middlewest Utilities*, 70 Fed. (2nd) 825, 826.

The Circuit Court recognized (Tr. 720) that with the debtor's answer consenting to and invoking the jurisdiction of the court, all jurisdictional requirements of the Act were satisfied, but it nevertheless felt constrained to hold that the debtor's answer and consent could not convert the involuntary proceeding into a voluntary one. In reaching this conclusion, the Circuit Court treated the answer and consent as "serving as a petition for reorganization" (Tr. 721). Neither the Seventh nor the Third Circuit suggested that such an answer constituted a new and independent petition for reorganization, nor was it so contended before the court below by any party. On the contrary, it has always been contended by petitioners, that the creditors' petition and the debtor's consent constituted but one petition upon the basis of which the court assumed jurisdiction.

The Circuit Court argued that such an answer, when treated as a voluntary petition, violated Sec. 126 of the Act, which provides that a Chapter X petition may be filed only "if no other petition by or against such corporation is pending under this chapter". Neither the history nor the intent of Sec. 126 warranted the application of that Section to a case where the debtor consents to a creditors' petition. The purpose of that Section was to avoid conflict between original petitions which were either concurrent or inconsistent, or original petitions which would create questions of priority between petitions, or original petitions filed in conflicting jurisdictions. (Finletter, The Law of Bankruptcy Reorganization, pp. 92 to 98).

An answer which consents to a Chapter X proceeding in effect merely adopts or sponsors the creditors' petition

and, therefore, does not come within the prohibition contained in Sec. 126. Such an answer does not give rise to two separate petitions. It is but one petition, one proceeding, one court. It is the equivalent of a decree *pro confesso,* which has long been recognized as part of equity jurisprudence and practice.

In the *Matter of Reisenberg,* 208 U. S. 90, 28 Sup. Ct. 219 (*supra*), this Court stated:

> "Jurisdiction does not depend upon the fact that the defendant denies the existence of the claim made, or its amount or validity. If it were otherwise, then the circuit court would have no jurisdiction if the defendant simply admitted his liability and the amount thereof as claimed, although not paying or satisfying the debt. This would involve the contention that the Federal Court might be without jurisdiction in many cases where, upon bill filed, it was taken pro confesso, or whenever a judgment was entered by default. These are propositions which, it seems to us, need only to be stated to be condemned. The cases are numerous in which judgments have been entered by consent or default where the other requisites to the jurisdiction of the Federal Court existed. Hefner v. Northwestern Mut. L. Ins. Co., 123 U. S. 747-756, 31 L. ed. 309-313, 8 Sup. Ct. Rep. 337; Pacific R. Co. v. Ketchum, 101 U. S. 289, 296, 25 L. ed. 982-935."

This Court in discussing the applications of equitable principles in interpreting the provisions of the Act, stated in *Securities and Exch. Commission* v. *United States Realty & Improvement Co.,* 60 Sup. Ct. 1044, 310 U. S. 434, as follows (p. 1053 Sup. Ct., p. 455 U. S.):

> "A bankruptcy court is a court of equity, sec. 2, 11 U. S. C. Sec. 11, 11 U. S. C. A. sec. 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. Bardes v. Hawarden Bank, 178 U. S. 524, 534, 535, 20 S. Ct. 1000, 1004, 44 L. Ed. 1175; Continental Illinois Nat. Bank & T. Co. v. Chicago R. I. & Pacific Ry., 294

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(p. 1054 Sup. Ct., p. 457 U. S.):

"While a bankruptcy court cannot, because of its own notions of equitable principles, refuse to award the relief which Congress has accorded the bankrupt, the real question is, what is the relief which Congress has accorded the bankrupt and is it more likely to be secured in a Chapter X or Chapter XI proceeding? In answering it we cannot assume that Congress has disregarded well settled principles of equity, the more so when Congress itself has provided that the relief to be given shall be 'fair and equitable and feasible'. Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."

The construction we suggest is in harmony and consonant with all other provisions of the Act and the decisions above cited.

Section 142 provides as follows:

"If an answer is not filed by a debtor to a petition against it, or if the answer filed does not controvert any material allegation of the petition, the judge shall enter an order approving the petition if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Since the District Court may approve a petition if the debtor defaults or its answer does not controvert any material allegations of the petition, how can it be said that it has not the power to accept an answer and consent, *pro confesso?* Such an answer is none the less one that does not "controvert any material allegations of the petition".

With such an answer we do not have a new and original proceeding. We have but one proceeding which is the equivalent of a voluntary one.

Palisades-on-the-Desplaines; 89 Fed. (2d) 214 (*Supra*);
Park Beach Hotel Building Corp., 96 Fed. (2d) 886 (*Supra*);
Snyder v. *Fenner,* 101 Fed. (2d) 736 (*Supra*).

Again the Circuit Court sacrifices substance for form when it construes Sec. 137 and concludes that a debtor by its consent cannot thereby prevent a creditor or stockholder from making issuable the commission of an act of bankruptcy.

The Court first advances the following cogent reasoning in support of the position that a creditor and stockholder should not have that right. It said (Tr. 722, 723):

> "The fifth—an act of bankruptcy—is even more clearly for its protection. It is impossible to see how a creditor or an 'indenture trustee' can have any interest in denying any one of them, assuming that the debtor's affairs are ripe for reorganization; and if Sec. 137 must be construed to give them that privilege, it was apparently an oversight. We do not forget that before 1938 a creditor, intervening in a liquidation proceeding, did have the privilege of contesting the act of bankruptcy; if he had a lien subject to challenge, this gave him the power to scotch the attack in limine. But Sec. 18 (b) has now been amended so that he no longer has that privilege, being relegated to his defense if the trustee attacks his lien. It will certainly be a curious anomaly if a creditor retains that privilege in reorganization which he has just lost in liquidation. As to shareholders, the privilege of denying the allegation required by Sec. 137 is of use only in cases where they could dispute a voluntary petition as well; that is, in those where the debtor's management was acting in fraud of their rights.

> For these reasons it seems to us at least doubtful that when, as here, the debtor chooses to pray for the approval of an involuntary petition, either creditor, 'indenture trustee' or stockholder can press to decision the added allegation required by Sec. 131; that is, can vicariously assume the debtor's defense as to something against which it does not want protection and in which as such the creditor can have no interest."

Despite these forceful arguments, the Circuit Court nevertheless concludes that "if Sec. 137 is read with strict literalness" a creditor or stockholder must retain the right to put in issue the commission of an action of bankruptcy, at the same time recognizing that this conclusion is a "curious anomaly".

This Court, in *Securities Exchange Commission* v. *United States Realty and Improvement Co.* (*Supra*), held "that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part". The Circuit Court has not done this and has disregarded the intent of Congress. If Sections 130, 131 and 137 are read together, instead of distributively, it becomes apparent: that Sec. 131 was enacted solely for the benefit of the debtor; that if the debtor itself seeks reorganization and joins with the creditors to obtain the approval of the petition, it should not be deprived of the rights which are expressly given it by Sec. 130; and that Sec. 137 was intended to give a creditor or stockholder the right to raise only those issues which would be available to them if the petition had been a voluntary one.

This construction still reserves to creditors and stockholders all issues other than those involved in the allegations required by Sec. 131 and also preserves the functional efficiency of the Act.

POINT II

The Circuit Court of Appeals for the Second Circuit by its decision seriously impedes the proper administration of Chapter X.

Section 77B and Chapter X were enacted for the primary purpose of simplifying and expediting the complicated and cumbersome reorganization procedure which formerly existed in equity proceedings. The Circuit Court, in disregard of the fundamental purpose of Section 77B and Chapter X, has read into the Act conditions which frustrate its purpose and which operate to prevent a speedy reorganization. It has abolished a decree pro confesso to the jurisdiction of the court in Chapter X proceedings initiated by creditors, and has created impediments which did not even exist in equity proceedings.

The Circuit Court has hamstrung any debtor in need of reorganization under Chapter X where the creditors have taken the initiative by filing a petition for reorganization and where none of the statements required by Sec. 131 factually exist or may be issuable. If its decision is to be adhered to, a debtor in need of reorganization under such circumstances has a choice of only one of three courses: (a) to file an answer admitting all of the allegations of the creditors' petition, including an act of bankruptcy; (b) to default in pleading; or (c) to contest the creditors' petition.

As a practical matter no officer or director of the corporation will admit that an act of bankruptcy has been committed, whether it be by default in pleading or by direct admission, if in fact no such act had been committed, or if the act was issuable. In many instances the admission of an act of bankruptcy may place directors and officers in a position where they may be personally liable to the debtor and to creditors (New York Stock Corpora-

tion Law, Sec. 15). Yet, the interests of the debtor, its stockholders and creditors may best be served by an immediate approval of a creditors' petition for reorganization with the same force and effect as though it were a voluntary one.

Since the Circuit Court holds that the debtor may not proceed with the creditors' petition as though it had been a voluntary one by the filing of a consent thereto, the only course left open to directors and officers under such circumstances is to put in issue the act of bankruptcy, thereby necessitating a trial of these issues. This would foist upon the court, the debtor and the creditors, protracted and expensive hearings for the purpose of taking testimony of appraisers, engineers and public accountants with respect to the question of insolvency and preference. It would also inevitably delay reorganization and in many cases even defeat an ultimate reorganization. It would doubtlessly adversely affect the debtor's credit position and the operation of its business.

Unless all parties to the controversy immediately consented to a dismissal of the petition, it would be necessary to conduct this protracted and needless litigation in order to clear the ground for a dismissal of the creditors' petition before the debtor could file a voluntary petition for reorganization, which it required in the first instance and sought by its consent. The inherent practical difficulties to such a procedure are apparent.

Furthermore, if the rule laid down by the Circuit Court is to be applied, then even where the officers or directors might be willing to assume the risk of admitting an act of bankruptcy, though issuable or non-existent, such an admission would not be conclusive and would not preclude a creditor or stockholder from insisting upon a trial of that issue. In that event, the same disruption of the functional provisions of the Act would ensue, to the detriment of the debtor and all parties to the reorganization.

Moreover, such a procedure would open up a broad avenue for creditors or stockholders who for personal reasons or gain may desire to delay a debtor in need of reorganization, by contesting an issue which is no longer material.

Surely, such unsatisfactory results, which violate every principle of equitable jurisprudence and which vitiate the functional aspects of the Act, were not intended by Congress and should not be read into the Act.

The instant case furnishes a concrete example of the impractical effect of the Circuit Court's decision. One year after the approval of the petition, the parties are back where they started from, even though all parties agree that the debtor is unable to pay its debts as they mature and can not continue unless reorganized.

POINT III

Rule 15(a) of the Rules of Civil Procedure does not apply to a Chapter X proceeding.

The Circuit Court has held that under Rule 15(a) the debtor could have, as a matter of right, filed a new answer within twenty days after it had filed its original consent.

In construing the provisions of the Act, the Circuit Court treated the consent of the debtor as constituting an "independent petition"; yet in holding that Rule 15(a) was applicable, it treated the consent as being merely an "answer".

It was apparent to the Circuit Court that if it considered the consent as a petition, the debtor might not have been able to withdraw it because of Sec. 59(g). It said: (Tr. 723, 724):

> "On the other hand Sec. 59(g) may give to creditors standing to object to the withdrawal of a petition, though they have not acted in reliance upon it, whenever its pendency gives them an advantage. In Re

> Sullivan, 23 Fed. Supp. 142. Indeed in In Re Epstein, 12 Fed. Supp. 450 (fol. 726), and In Re Browne, 30 Fed. Supp. 157, the court apparently refused leave to withdraw only because the bankrupt had not made out a satisfactory excuse."

The above principles of law apply as forcibly whether the debtor's pleading is termed "a petition", "an answer", or "a consent". Regardless of what nomenclature is applied to that pleading, since it specifically consents to and prays for a reorganization and is the basis upon which the court had assumed jurisdiction and entered its approval order, it should be conclusive and binding on all parties and not subject to withdrawal as a matter of right.

This Court, in *Case* v. *Los Angeles Lumber Co.*, 60 Sup. Ct. 1, 308 U. S. 106, at page 12-13 Sup. Ct., pages 125-127 U. S., said:

> "A debtor as well as a creditor who invokes the aid of the Federal Courts in reorganization or rehabilitation under Section 77B assumes all of the consequences which flow from that jurisdiction.
>
> * * * * * * *
>
> And once the jurisdiction of the court has been invoked, whether by the debtor or by a creditor, that petitioner cannot withdraw and oust the court of jurisdiction. He invokes that jurisdiction risking all of the disadvantages which may flow to him as a consequence, as well as gaining all of the benefits.
>
> * * * * * * *
>
> When that jurisdiction attached, the court rather than the stockholders was in control with all of the powers and duties which that entailed under Sec. 77B."
>
> * * * * * * *

Rule 15(a) can not be applied to circumvent the aforesaid principles of law so as to divest, as a matter of right, the jurisdiction which the court has acquired. It is a Rule

which is limited to amendment of pleadings before judgment. Since an order of approval of a petition is a judgment of a court, that Rule can not be used as a basis for vacating the judgment as a matter of right by merely serving an amended pleading.

POINT IV

The decision of the Circuit Court of Appeals for the Second Circuit conflicts with the decision of this Court and the Court of Appeals of the State of New York.

The Special Master and the District Court have found that the authorization by the board of directors for the filing of the consent to a Chapter X proceeding was "a bona fide and proper exercise by the board of directors of their judgment under the existing circumstances" (Tr. 82). Not the slightest indicia of fraud or bad faith on the part of the directors was established (Tr. 83-84). The Circuit Court has not overruled these findings nor has it in any way disturbed them. The allegations of fraud charged by the majority stockholders were predicated upon the fact that they had desired to proceed under Chapter XI, whereas the directors, in the interest of creditors, and of all stockholders, and the debtor, had consented to a Chapter X proceeding. The Special Master and the District Court held that adequate relief could be obtained only under Chapter X (Tr. 85-86). This finding also has been neither overruled nor even critized by the Circuit Court (Tr. 724).

The Circuit Court said (Tr. 724): "* * * directors, so long as they hold office and use an honest judgment, are immune from the control of their shareholders, *People ex rel. Manice* v. *Powell,* 201 N. Y. 194, 200, 201,". Notwithstanding the recognition of this principle, the Circuit Court went on to say: "the power to commit a corporation one

day before they know they are to be displaced, to a course known to be disapproved by the majority is not one to be generously extended. Normally the shareholders should have their way".

Shall the tenure of office be the test of the propriety of directors' acts? As long as a board of directors is duly constituted and in office, as is the case here, it has the right and duty to act on behalf of the debtor with due consideration to the rights of the creditors and all stockholders.

The directors of a corporation unable to meet its obligations owe a duty to its creditors as well as to its stockholders. Finletter, on page 41, "The Law of Bankruptcy Reorganization" states:

> "The properties of the debtor become charged with a prior responsibility to creditors, as is evidenced by the many restrictions placed upon the directors in dealing with those assets after insolvency supervenes. The directors then cease to represent the stockholders alone and must manage the property for the benefit of creditors as well as stockholders. A provision prohibiting them from filing a petition for bankruptcy reorganization at a time when they might conceive it to be to the best interests of the enterprise as a whole to do so would accordingly seem to be in conflict with the paramount bankruptcy power."

This Court in *Royal Indemnity Co.* v. *American Bond & Mortgage Co.*, 289 U. S. 165, 53 Sup. Ct. 551, held that the directors by resolution may authorize the institution of or the consent to an insolvency proceeding, and that such an act does not require a shareholder's vote for its validity. The Court of Appeals of the State of New York has also enunciated that principle.

> *Rogers* v. *Pell*, 154 N. Y. 518, 527;
> *Young* v. *Stone*, 61 App. Div. 364, 369, 70 N. Y. S. 558 (aff'd 174 N. Y. 517), 66 N. E. 1118.

Indeed even the Circuit Court for the Second Circuit adhered to that principle in earlier cases.

In Re Lone Star Shipbuilding Co., 6 Fed. Rep. (2d) 192, 195;
In Re C. Moench & Sons Co., 130 Fed. Rep. 685, 678;
Regal Cleaners & Dyers Inc. v. *Merlis, et al.*, 274 F. 915, 916.

It is submitted that a board of directors may commit a corporation to a course of procedure in a reorganization proceeding irrespective of the wishes of the majority stockholders, as long as it is a duly constituted board of directors who act in good faith and without fraud. It is immaterial when their term of office is to terminate.

Respectfully submitted,

RAYMOND J. SCULLY and
HILBERT I. TRACHMAN,
Counsel for Petitioners.

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FILED
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Supreme Court of the United States

OCTOBER TERM, 1940.

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN,

Petitioners,

against

AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

WEINSTEIN & LEVINSON,
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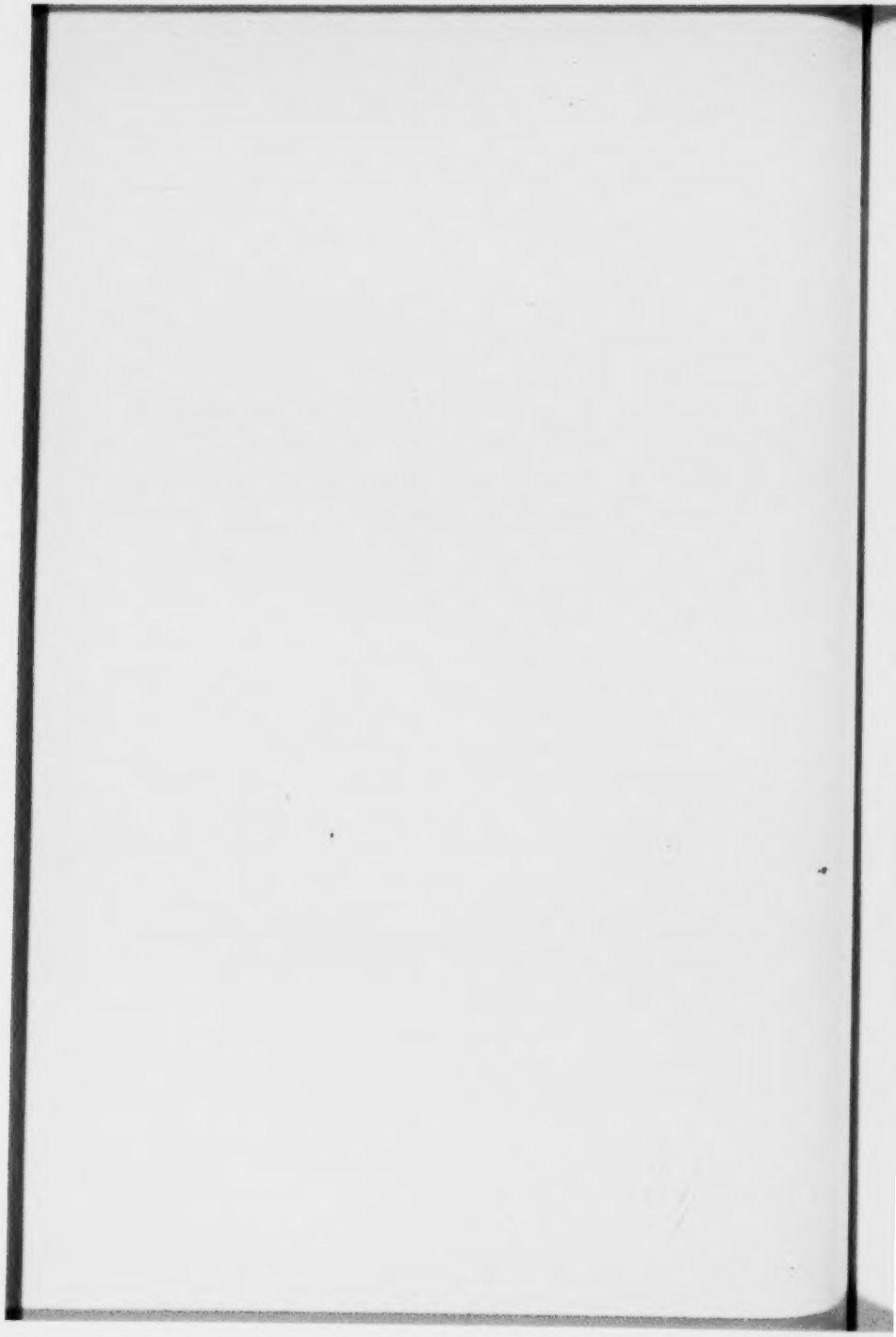

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

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Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

Statement.

This is an application by three creditors of J. P. Linahan, Inc., who filed an involuntary petition for reorganization under Chapter X of the Bankruptcy Act, and by Anna Louise Linahan, a minority stockholder, for a writ of certiorari to review an order of the United States Circuit Court of Appeals for the Second Circuit, filed on February 14, 1941 (R. 725) insofar as that order reverses an order made on May 18, 1940, by the United States District Court for the Southern District of New York

(R. 65). This order of the Circuit Court granted permission to J. P. Linahan, Inc., the debtor, to serve and file an amended answer to the involuntary petition.

The order of the District Court dated May 18, 1940, which was reversed in its entirety, approved the findings of fact, conclusions of law and the report of the Special Master, and approved the involuntary petition of the creditors and the original answer of the debtor as properly filed under Chapter X of the Bankruptcy Act (R. 65-67). As the powers of the Special Master were expressly limited to the taking of evidence and reporting to the District Court with his recommendations (R. 157), and as the order of the District Court confirming the Special Master's report was entirely reversed and as this order of reversal was made the order of the District Court, it necessarily follows that the findings of fact and conclusions of law of the Special Master stand unapproved.

Opinions Below.

The petitioners do not seek to review, as claimed by them, the opinion of the Circuit Court of Appeals, Second Circuit, dated January 27, 1941, which is reported as *Moore* v. *Linahan* in 117 Fed. (2nd) 140 (R. 718-724), but only one isolated portion of the opinion, which relates to the granting by the Circuit Court, in its discretion, to the respondent debtor, of permission to file an amended answer to the involuntary petition. The opinion relates to 10 separate orders in this proceeding which were appealed from. The petition for certiorari seeks a review of only so much of the order of the Circuit Court, which reversed the order of the District Court of May 18th, 1940, and which granted leave to the debtor to file a new answer. The foregoing opinion of the Circuit Court of Appeals likewise refers to its prior opinion rendered

in this proceeding in *In re J. P. Linahan & Co.*, 111 Fed. (2nd) 590 (R. 719). The decision of the Circuit Court of Appeals as embodied in this last-mentioned opinion, reversed an injunction granted by the District Court on March 20, 1940 which prevented the respondents, majority stockholders of the debtor from electing directors of their own choice (R. 719). This injunction, in turn, wrongfully prevented the debtor, through its new Board of Directors, from filing an amended answer within the statutory period (R. 719).

Jurisdiction to Grant Certiorari is Lacking, And, in Any Event, Should Not Be Exercised.

(1) The granting of permission by the Circuit Court of Appeals to the debtor to serve an amended answer was an act of procedural discretion.

The Circuit Court of Appeals granted permission to the debtor to serve an amended answer, not as a matter of right, but in the exercise of its sound discretion.

On July 5, 1940, the District Court signed an order denying the application made by the debtor through its majority stockholders and directors, for leave to reopen the order of confirmation, and granting leave to the debtor to serve and file an amended and supplemental anwer (R. 228-9). An appeal was taken from this order (R. 143) and the Circuit Court dismissed this appeal as moot, but granted the debtor leave to file a new answer (R. 725). The mandate issued by the Circuit Court provided as follows:

> "The appeal from the order of July 5th denying leave to reopen the order of confirmation is dismissed, but the debtor is granted leave to file a new answer."

The permission to the debtor to serve a new amended answer was granted in the sound discretion of the Circuit Court and is not the proper subject of review by this Court.

> *Clawans* vs. *Whiteford*, 55 Fed. (2nd) 1037 (cert. denied 287 U. S. 605.

(2) The amended answer was duly served and filed on April 8, 1941, and the original answer of the debtor which consented to the involuntary petition, has already been withdrawn. The questions of law sought to be reviewed are therefore moot.

> *Mills* vs. *Green*, 159 U. S. 651, 653;
> *In re Smith* 71 Fed. (2nd) 378, 381, following the decision of this court in *American Book Co.* vs. *Kansas*, 193 U. S. 49;
> *Bennell Realty Co.* vs. *E. G. Shinner & Co., Inc.*, 87 Fed. (2nd) 824, (cert. denied, 302 U. S. 693).

The mandate of the Circuit Court of Appeals dated February 13, 1941, was duly filed in the office of the Clerk of the District Court on February 14, 1941. On April 3, 1941, an order of the District Court was entered making the order of the Circuit Court of Appeals the order of said District Court. This order, in part provided:

> "* * * but the debtor be, and it is hereby granted leave to file a new answer within twenty days after the filing of this order; * * *".

Such new answer, in the form of the debtor's amended answer, was duly served on the attorneys for the petitioners on April 8th, 1941 and accepted by them, and the original amended answer with proof of service was

duly filed on said day in the office of the Clerk of the District Court. No application was made by the petitioners for a stay of the mandate or a stay of any of the proceedings herein, pending the present application for a writ of certiorari. As the debtor has already duly served and filed its amended answer which withdrew the original answer, the question of the propriety of the filing of such amended answer is now moot.

Facts.

The annual meeting of stockholders of the debtor for the election of directors was scheduled to take place, in accordance with the provisions of its By-Laws, on February 24th, 1940 (R. 232). Four days prior thereto, and on February 20, 1940, three creditors of the debtor filed an involuntary petition for a reorganization of the debtor under Chapter X of the Bankruptcy Act (R. 232), alleging that the debtor is insolvent, that various acts of bankruptcy were committed, and that it was the desire of the petitioners to eliminate the stockholders' interest (R. 232; 5-13).

On the very next day, the debtor signed a sworn answer, appearing by George J. Corbett, Esq., as its attorney, in which it consented to the immediate approval by the Court of said involuntary petition, and which did not controvert a solitary allegation of fact set forth in such petition (R. 232; 13-17). Mr Corbett was, for a number of years, and up to about 2 weeks prior to the filing of the petition, a director and treasurer of the debtor, and the personal attorney for the respondent Agatha L. Moore and her family (R. 232-3). It was his duty, as treasurer, to countersign all checks. It is evident that no preferential payments could possibly have been made to any creditors without his approval (R. 233).

The respondent Agatha L. Moore and her family, who were majority stockholders of the debtor since 1924 (R. 233) relied upon his advice and his agreement, as their personal attorney, to look after and protect their interests. They permitted the directors of the debtor to be nominated and elected under his directions. Mr. Corbett resigned as a director and treasurer on February 6, 1940, when it became evident that some legal proceedings would have to be taken in the Bankruptcy Court for the protection of the debtor. Mr. Corbett, appearing as the attorney for the debtor, filed an answer consenting to the reorganization of the debtor as prayed for by the petitioning creditors, thereby opposing his former clients in their request that a petition for an arrangement be filed under Chapter XI of the Bankruptcy Act, and that the annual meeting of stockholders be held as promptly as possible so that the stockholders could exercise their legal right to vote for the election of directors (R. 233).

This answer was filed notwithstanding the fact that this attorney knew that the involuntary petition expressly alleged that it was the desire of the petitioning creditors to eliminate the interests of all stockholders (R. 233). At such time, the respondent Agatha L. Moore was the record owner of 1700 shares of common stock of the debtor, having a par value of $170,000 which was more than a majority of the issued stock (R. 233). The schedule annexed to the petition showed that the debtor had gross assets of about $416,000 and liabilities of about $234,000 (R. 12-13, 233).

On the same day that this answer was prepared, Lester S. Berry, as President, and James W. Lynch, as Secretary, signed a certificate indicating that appropriate resolutions of the directors were passed approving such involuntary petition (R. 15-17, 233-4).

A stockholders' meeting was not called in order to obtain their consent for such approval (R. 234). Such reso-

lutions were passed with full knowledge of the fact that they were directly opposed to the desires of the majority stockholders, and just a few days before the date set for the annual meeting of stockholders of the debtor, when a new Board of Directors was to be elected (R. 234). This answer was drafted by the attorney for the petitioning creditors and typewritten in final form by the attorney for the petitioner, Mrs. Anna Louise Linahan, a minority stockholder and a sister-in-law of the respondent Agatha L. Moore, who has asserted large claims and threatened suit against said respondent and her family, based on alleged transactions which are unrelated to this proceeding (R. 63, 234, 701). She also filed an answer as a minority stockholder joining in the request for a reorganization as demanded in the petition (R. 31-33).

It is apparent that the filing of the involuntary petition on February 20, 1940, and the verification of the answer by the debtor on the following day consenting to such petition, were for the purpose of preventing the holding of such annual meeting of stockholders then set for February 24, 1940, and in order to prevent the stockholders from electing directors of their own choice (R. 234). This answer was actually filed on February 23rd, 1940, one day before the day set for the annual meeting of stockholders (R. 234).

In the meantime, Agatha L. Moore, one of the respondents, as a creditor of the debtor then holding its promissory notes in excess of $37,000, filed an answer controverting the allegations of the involuntary petition and setting up an affirmative defense to the effect that it was not filed in good faith in that adequate relief could be obtained by the debtor under the provisions of Chapter XI, and that it is unreasonable to expect that a plan of reorganization can be effected as prayed for by the petitioning creditors (R. 20-22).

An answer was also filed by the respondents Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins as stockholders of record of the debtor together owning in excess of 60% of all its issued and outstanding capital stock (R. 23-31). This answer also controverted the material allegations of the involuntary petition, alleged that the debtor was solvent, that adequate relief could be obtained under Chapter XI and that the answer of the debtor consenting to the petition was fraudulently filed and in violation of the fiduciary obligations which the directors owed to the stockholders of the debtor (R. 23-31), and also set up an affirmative defense pleaded derivatively in behalf of the debtor, alleging that the answer filed by the debtor was filed fraudulently and in violation of the fiduciary obligations owed by the directors to the stockholders (R. 27-30).

On February 26, 1940, an order to show cause was obtained by the respondents Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, together owning 1800 shares or more than 60% of all of the issued and outstanding stock of the debtor, for an order granting them permission to hold the annual stockholders' meeting for the election of directors and for other relief (R. 234).

On March 14, 1940, the petitioning creditors procured an order to show cause to enjoin a special stockholders' meeting which had been called by the individual respondents for the express purpose of passing appropriate resolutions condemning the actions of the Board of Directors in filing an answer consenting to the involuntary petition for reorganization under Chapter X, and authorizing counsel for the debtor to take appropriate legal proceedings to have such answer withdrawn or to procure permission of the court to file an amended answer in which the material allegations of the involuntary petition would be controverted and in which a demand would be made for

the dismissal of the involuntary petition. After argument of both motions, an order was entered on April 2, 1940, denying the motion of the respondents for leave to hold the annual stockholders' meeting, and granting the motion of the petitioning creditors for an injunction restraining the holding of the special stockholders' meeting. An appeal was promptly taken to the Circuit Court of Appeals from such order.

The issues raised by the answers that were filed to the involuntary petition were referred to a Special Master "to hear and report generally as to all matters arising in this proceeding" (R. 151). Hearings were commenced on March 18, 1940 (R. 376) and concluded on April 6, 1940 (R. 595, 610). At such hearings Mr. Taylor, a member of the Creditors Committee, and a witness called on behalf of the petitioning creditors, testified that Mr. Trachman, the attorney for petitioner Anna Louise Linahan, was asserting a claim against respondent Mrs. Moore and her family on some outside transactions (R. 461) and that "he seemed to be more concerned with his other claims than with anything else" (R. 462). The evidence indicates that the petitioner Anna Louise Linahan, filed an answer as a stockholder consenting to a reorganization of the debtor under Chapter X (R. 31-33), primarily for the purpose of forcing the majority stockholders to settle the litigation pending between them and said Anna Louise Linahan. On April 26, 1940, the Special Master filed his report recommending the approval of the involuntary petition (R. 68-89).

On May 6, 1940, the Circuit Court of Appeals reversed the aforesaid order appealed from (*In re J. P. Linahan, Inc.*, 111 Fed. [2nd] 590), and a mandate was duly issued accordingly on May 7th, 1940, and filed in the office of the Clerk of the District Court on May 8, 1940, which mandate directed that the order of April 2, 1940, denying the motion of the respondents for leave to hold the annual

stockholders' meeting and granting the motion of the petitioning creditors for an injunction restraining the holding of a special stockholders' meeting, be reversed, and such meeting be permitted to be held.

On May 10, 1940, an order was entered making the mandate of the Circuit Court the order of the District Court (R. 235).

On May 10, 1940, the annual meeting of stockholders for the election of directors was held, and 5 directors were elected subject to the approval of the District Court. Thereupon and upon the same day, an order to show cause was procured returnable May 14, 1940, for an order approving the election of such directors (R. 235).

On May 11, 1940, a special meeting of stockholders in accordance with the provisions of the By-Laws was duly held. This was the meeting which was originally scheduled to be held on March 16, 1940, and which was enjoined by the entry of the order dated April 2, 1940, granting the motion made by the petitioning creditors and joined in by the petitioner, Anna Louise Linahan. This was the order which was reversed by the Circuit Court on May 6th, 1940. At this meeting, resolutions were duly passed opposing the involuntary petition and requesting the directors and counsel for the debtor to take appropriate legal proceedings in order to procure permission of the District Court to strike out the original answer of the debtor as illegally filed, or in the alternative, for leave to serve and file an amended and supplemental answer for the debtor controverting the material allegations of the petition, and seeking its dismissal (R. 238-9).

On May 13, 1940, an application was made in behalf of the majority stockholders and on behalf of the respondent Agatha L. Moore as answering creditor, returnable on May 15, 1940, for an order staying the hearing on the application to confirm the Special Master's report dated April 26, 1940, until after the determination by the

District Court of the application which was intended to be made in behalf of the debtor for leave to file an amended supplemental answer in its behalf and for leave to reopen the trial of the issues before the Special Master accordingly (R. 235-6). This motion for a stay was denied by order dated May 18, 1940 (R. 46).

On May 18, 1940, the court signed an order approving the Special Master's report dated April 26, 1940, and approving the involuntary petition and the answer of the debtor as being properly filed under Chapter X of the Bankruptcy Act (R. 65-67).

On May 27, 1940, an order was signed approving the election of the five directors who were nominated and voted for by the majority stockholders (R. 238). The respondents, notwithstanding the fact that they acted as speedily as possible, were not in a legal position to make any motion for leave to serve an amended and supplemental answer until the new directors elected by them were first approved by the District Court (In re J. P. Linahan, Inc., 111 Fed. [2nd] 590, at 591, 592). The majority stockholders were thus delayed until May 27th, 1940 (R. 236, 246), in having control of the debtor's Board of Directors, notwithstanding the fact that they specifically called the court's attention to the urgency of having an order entered promptly approving the election of the new directors (R. 634). In the meantime, from February 20th, 1940, the date when the involuntary petition was filed, the debtor was in the control of a hostile and unfaithful Board of Directors who were selfishly acting for their own personal interests. This delay was due entirely to the illegal objections made by the petitioners which were originally sustained by the District Court and unanimously reversed by the Circuit Court of Appeals on May 6th, 1940 (R. 238). The petitioners originally gained a legal advantage by their own illegal acts. By frustrating the holding of the annual meeting scheduled to be held

on February 24th, 1940, they wrongfully prevented the debtor, through a new Board of Directors who could then have been elected by the individual respondents, from filing an amended answer for the debtor controverting the material allegations of the involuntary petition and demanding its dismissal (R. 238).

On June 3, 1940, a special meeting of directors was held at which similar resolutions were duly passed authorizing an application to be made to the District Court for permission, in behalf of the debtor, to serve and file an amended and supplemental answer (R. 238), which answer would controvert the material allegations of the involuntary petition, and instead of consenting to reorganization under Chapter X, would seek its dismissal (R. 238).

At the time of the filing of the involuntary petition, the debtor was solvent and no act of bankruptcy had ever been committed (R. 422-3, 695, 513-4).

At the trial of the issues before the Special Master, James W. Lynch, the Secretary and Treasurer of the debtor, who was called as a witness by the petitioning creditors, testified that at a fair valuation of the assets of the debtor, it had approximately $182,000 assets over and above its liabilities (R. 422-3), and that the book value of the shares of stock of the corporation was about $50 per share (R. 240, 449). The report of certified public accountants appointed by the District Court, which report was adopted by the court (R. 71-2), indicates that the debtor, at the time of the filing of the petition, was solvent, having a net worth of $134,505.99 (R. 695, 597). Mr. Scully, the attorney for the petitioning creditors, testified that the creditors always wanted 100 cents on the dollar (R. 509), and that they always thought that the company was solvent (R. 508). He further testified as follows (R. 513-4):

> "Q. When you filed the involuntary petition did you know that no Act of Bankruptcy or that any

Act of Bankruptcy had been committed by this Debtor? A. I don't know it now."

At the time the original answer was filed on behalf of the debtor, the total stock ownership of the then Board of Directors constituted less than 5% of the entire issued and outstanding stock of the debtor. At such time both the president and secretary were still indebted to the debtor for monies borrowed by them (R. 240, 695).

The Nahanil Realty Corporation, a creditor having liquidated claims against the debtor in large sums, and all the stock of which is owned by respondent Agatha L. Moore and her family, is likewise opposed to such involuntary petition. The total claims of the corporation and respondent Agatha L. Moore represent more than one-third of the total debts due by the debtor (R. 13, 438). The debtor has no secured obligations or debts (R. 34, 435).

On July 5, 1940, an order was entered denying the application made by the debtor through its majority stockholders and newly elected directors, for an order vacating and setting aside the order of the District Court made on May 18, 1940, which approved the involuntary petition, and for leave to reopen the trial of the issues before the Special Master, and granting leave to the debtor to serve and file an amended and supplemental answer (R. 228-9).

On January 27, 1941, the Circuit Court of Appeals reversed the order the of the District Court dated May 18, 1940 which confirmed the Special Master's report dated April 26, 1940, dismissed the appeal from the order of the District Court dated July 5, 1940 which denied leave to the debtor to reopen the order of confirmation, but granted the debtor leave to file a new amended answer, affirmed some other interlocutory orders, reversed others, and dismissed some appeals from some of the other orders as moot (R. 726), and directed a new trial to be had on the new issues to be raised by the new

amended answer (R. 725). Such new trial has as yet not been held, but there is now pending undetermined a motion by the debtor for judgment on the pleadings or in the alternative for summary judgment dismissing the involuntary petition, which motion has been adjourned, upon the petitioners' application, pending the decision by this Court on the present application for a writ of certiorari.

A summary of the respective parties and the position taken by them in this proceeding, is as follows:

In Favor of the Chapter X Proceeding:

(1) Sargent & Company, *et al.*, Petitioning Creditors, Petitioners—Claim in their petition to represent 7 creditors whose claims aggregate $71,717.31 (R. 6-7).

(2) Anna Louise Linahan, Petitioner—A stockholder owning 25% of the capital stock of the debtor; the sister-in-law of respondent Agatha L. Moore; has asserted large claims against Mrs. Moore and her family; has other litigation pending between herself and said respondent. The debtor has filed a counterclaim against the Estate of J. P. Linahan, deceased, of which Anna Louise Linahan is the executrix, for over $150,000 in an action which is still pending undetermined (R. 693, 701).

(3) J. P. Linahan, Inc., acting through Lester S. Berry, its President, and James W. Lynch, its Secretary & Treasurer, as debtor in possession, appellee in the Circuit Court of Appeals, but not appearing in this court. The District Court has drawn a distinction between a debtor and a debtor in

possession (R. 218, 281). The debtor in possession, as distinguished from the debtor, was an appellee in the Circuit Court of Appeals. Lester S. Berry, its president, and James W. Lynch, its Secretary & Treasurer, were those responsible for the filing of the original answer on behalf of the debtor on February 23, 1940, consenting to the Chapter X proceeding, notwithstanding the protest of the majority stockholders (R. 13-19). Both Berry and Lynch are indebted to the debtor in sums of money which they borrowed (R. 690). Berry owns 60 shares of stock or about 2% of the entire issued capital stock of the debtor, and Lynch owns 10 shares or about ⅓ of 1% thereof. Berry formerly procured a discharge in bankruptcy, acting through Trachman, who is also the personal attorney for the petitioner Anna Louise Linahan. Through this proceeding he discharged a debt of $8500 due to the debtor. The respondent Agatha L. Moore and her family subsequently voluntarily contributed $6000 to the corporation so that this discharged debt could be paid as a result of which Berry procured the return of 60 shares of stock of the debtor which were pledged with the debtor as collateral (R. 240-2). He expressed his thanks to the respondent Agatha L. Moore in writing for this gift (R. 241). Under the management of Berry and Lynch, the debtor lost over $150,000 in the last three years (R. 515).

Opposed to the Chapter X Proceeding:

(1) J. P. Linahan, Inc., Debtor, Respondent—Acting through its new board of directors who were elected and approved by order of the court dated May 27, 1940 (R. 112).

(2) AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, Respondents—Answering stockholders owning more than 60% of the entire issued capital stock of the debtor (R. 437).

(3) AGATHA L. MOORE, Respondent—Answering creditor who has claims represented by promissory notes, in excess of $37,000. She and her family also own the stock of the Nahanil Realty Corporation, which corporation and Agatha L. Moore have liquidated claims against the debtor in excess of one-third of its total liabilities (R. 438). The Nahanil Realty Corporation owns the building occupied by the debtor as tenant (R. 692).

It is therefore apparent that the respondents are the ones who are vitally financially interested in successfully putting through a fair, equitable and feasible plan of reorganization through the medium of a petition for an arrangement under Chapter XI which can be filed pursuant to Section 147 as an amendment to the present involuntary petition, if the District Court should dismiss said petition.

Objections to the Petition.

The petitioners set forth five questions which they claim are involved in this application. Such questions are based upon a misconception of the decision of the Circuit Court of Appeals, upon a distortion of the evidence, and upon misstatements of fact.

The petitioners, on pages 2 and 3 of their petition, under the heading of "Questions Involved", set forth the five alleged questions which they claim are involved on their present application for a writ of certiorari.

The first question is as follows:

> "1. May a debtor which has invoked the jurisdiction of the Federal Court by filing prior to approval of an involuntary petition, a written admission of its inability to meet its debts as they mature, a consent to reorganization under Chapter X, and a request for approval of the Chapter X petition, defeat such jurisdiction by withdrawing such consent under the guise of filing an amended answer, although it appears after trial the debtor requires reorganization under Chapter X?"

The statement that it appears after trial that the debtor requires reorganization under Chapter X, is a misstatement of fact. One of the affirmative defenses set forth in the amended answer is that there is no need for reorganization by the debtor under Chapter X, as adequate relief can be obtained under Chapter XI. This will be one of the questions to be determined on the new trial, and new findings of fact and conclusions of law will necessarily have to be made by the Special Master and submitted to the District Court for its consideration. The majority stockholders in their answer to the involuntary petition claimed that the original consent to reorganization filed by the old board of directors which is referred to in the above quoted question, was filed fraudulently and by a collusive arrangement between the petitioning creditors, the old board of directors of the debtor, and the attorney for the minority stockholder Anna Louise Linahan (R. 25-27). All evidence in regard thereto was erroneously excluded at the trial of the issues before the Special Master (R. 443-4, 445, 575-6, 448).

The second alleged question, which is set forth on page 3 of the petition, is as follows:

> "II. Do the provisions of Sections 126 and 142 of Chapter X of the Bankruptcy Act prohibit a debtor

from expediting the proceeding by consenting to reorganization and requesting the approval of an involuntary petition?"

No such question is involved. The Circuit Court in its discretion granted permission to the debtor to file an amended answer because the debtor was wrongfully prevented from filing an amended answer within the statutory period. The Circuit Court, in its opinion (R. 719-20) said:

> "We start with the now incontravertible fact that it was unlawful to forbid the election of directors. It was only by virtue of the erroneous injunction that the old board continued in office, but by so doing it wrongfully prevented the new board from filing an amended answer within the time—twenty days after February 23rd—allowed them under Rule 15 (a). That answer would have withdrawn the debtor's consent to an approval of the petition and would have put in issue the act of bankruptcy along with all the other allegations of the petition."

The third alleged question which is set forth on page 3 of the petition, is as follows:

> "III. Does the creditors' petition in conjunction with the debtor's written admission of its inability to meet its debts as they mature, its consent to reorganization under Chapter X, and its request for approval of the Chapter X petition, satisfy the requirements of Secs. 130 and 131 of the Bankruptcy Act?"

This question has no possible bearing on the present application.

Upon the trial of the issues before the Special Master, the answer was amended on March 29th, 1940, so as to set forth denials of the allegations in the involuntary petition that the stock of the debtor was valueless, that

the company was insolvent, and that acts of bankruptcy had been committed (R. 493). It will be noted that this amendment was made by the debtor then acting through a hostile board of directors, as the new board was not yet approved by the court and could not become active directors until May 27th, 1940 (R. 112). Issues were therefore created which should have been tried as provided by Section 143 of the Bankruptcy Act.

The fourth alleged question, which is set forth on page 3 of the petition, is as follows:

> "IV. Was the Circuit Court required by Rule 15 (a) of the Federal Rules of Civil Procedure to permit the debtor to withdraw as a matter of right its written consent to reorganization under Chapter X and its request for approval of the Chapter X petition upon the basis of which the District Court had assumed jurisdiction?"

The Circuit Court granted permission to the debtor to serve an amended answer as an act of discretion because the debtor was originally wrongfully prevented from filing an amended answer in accordance with Rule 15 of the Rules of Civil Procedure.

Rule 15 of the Federal Rules of Civil Procedure, which are applicable to bankruptcy proceedings (General Order in Bankruptcy 37), provides in part as follows:

> "Rule 15. Amended and Supplemental Pleadings.
>
> * * * * *
>
> (c) Relation Back of Amendments. Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading."

The fifth alleged question, set forth on page 3 of the petition, is as follows:

> "V. Do the directors of a corporation in financial distress require the approval of the majority stockholders in order to consent to the jurisdiction of a court for a reorganization proceeding?"

The Circuit Court in its opinion recognized the fact that directors of a corporation who act in good faith would not require the consent of its stockholders (R. 724). It expressly set forth, however, that where directors acted in bad faith and in fraud of the rights of the stockholders of the company, the court of bankruptcy can properly prevent the perpretation of fraud (R. 724). The Circuit Court, in its opinion (R. 719) states:

> "* * * the directors of the debtor probably knew in advance of this proceeding, and possibly they inspired it; * * *."

This opinion further refers to the fact that the original answer was filed by the old Board of Directors, one day before February 24th, 1940, the date set for the annual meeting of stockholders when all of the old directors would have gone out of office (R. 719), and when such directors knew that their acts were against the desires of the majority stockholders (R. 724).

The petitioners, in their brief, lay particular stress upon findings of fact made by the Special Master to the effect that there was no fraud on the part of the old board of directors, and other findings, claiming that such findings have not been overruled by the Circuit Court. Such statements are contrary to the facts.

There is Now No Approval by the District Court of Any of the Findings of Fact or Conclusions of Law Made by the Special Master.

The Special Master was appointed "to hear and report generally as to all matters arising in this proceed-

ing" (R. 157). On April 26, 1940, the Special Master filed his report recommending the approval of the involuntary petition, and setting forth findings of facts and conclusions of law (R. 68-89). This report was confirmed on May 18, 1940, by the District Court (R. 65-67). The Circuit Court, however, completely reversed this order of confirmation (R. 724, 726).

The mandate of the Circuit Court dated February 13, 1941, and filed in the office of the Clerk of the District Court on February 14, 1941, provided:

> "IT IS HEREBY
>
> Ordered, Adjudged and Decreed
>
> That the order of confirmation of said District Court be and it hereby is reversed."

The order of the District Court dated March 31, 1941, and filed in the office of the Clerk of the District Court on April 3, 1941, made the foregoing mandate of the Circuit Court the order of the District Court, and after referring to the fact that the appeal was taken from the order signed by Hon. Alfred C. Coxe, District Judge dated the 18th day of May, 1940, confirming the findings of fact, conclusions of law and the report of the Special Master dated April 26, 1940, and approving the involuntary petition and the answer of the debtor, provided:

> "* * * and it is further
>
> ORDERED, ADJUDGED AND DECREED, that the order of confirmation signed by Hon. Alfred C. Coxe, District Judge, dated May 18th, 1940, be and the same hereby is reversed;".

It is clear, therefore, that when the order of confirmation dated May 18, 1940 (R. 65-67) was reversed by the

Circuit Court, the entire order was reversed, and not an isolated portion thereof, as claimed by the petitioners.

There is, therefore, no order in effect which confirmed the Special Master's report or any part thereof.

Furthermore, General Order No. 47 in Bankruptcy provides as follows:

> "No. 47. Reports of Referees and Special Masters.
>
> Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions."

After a trial of the new issues raised by the amended answer on behalf of the debtor which has already been served and filed, it will be necessary for the Special Master to submit new findings of fact and conclusions of law, and it will then be the duty of the District Judge either to adopt, modify or reject same in accordance with the foregoing General Order.

Furthermore, it is apparent from the opinion of the Circuit Court that there was no intent to confirm any of the findings of the Special Master, because the trial of the original issues before the Special Master was conducted on the original answer filed by the debtor, consenting to the involuntary petition, particularly where the debtor, acting through its old board of directors, appeared by its own attorney and cooperated with the petitioning creditors in an effort to sustain the petition (R. 13-19). The Circuit Court, however, in its opinion, granted leave to the debtor to withdraw the original answer and serve a new amended answer which would con-

trovert the material allegations of the involuntary petition and seek its dismissal. The Circuit Court of Appeals, in its opinion, said (R. 725):

> "After the amended answer has been filed the case will be tried upon the new issues."

All of the findings of fact and conclusions of law therefore, made by the Special Master, and which were based on the original answer of the debtor consenting to the involuntary petition, stand unapproved. The only order which approved such findings was reversed.

The statements, therefore, contained in the petitioners' brief that the Circuit Court has not overruled any of the findings of fact made by the Special Master or in any way disturbed them, and that such findings are at the present time in effect, are contrary to the facts.

The respondents have at all times denied that the debtor is insolvent (R. 20, 23) and have claimed that the debtor, at the time of the filing of the involuntary petition, was, and now is solvent, having assets at a fair valuation far in excess of all its liabilities (R. 25). None of the respondents have ever filed, as claimed on page 3 of the petition herein, any proposed plan of reorganization in this proceeding. Nor have the majority stockholders ever represented their stock to be worthless, as is set forth on page 5 of the petition, but have always denied such fact (R. 538).

The statement made on page 5 of the petition that the majority stockholders repeatedly represented the stock to be worthless, is a misstatement of fact. The only time that there was any testimony of an alleged claim by the majority stockholders that their stock was worthless, was when Mr. Taylor a witness on behalf of the petitioning creditors, stated that such statements were only made in connection with a discussion as to what would be realized in the event there was a liquidation of the assets of the debtor (R. 463).

POINT I.

The decision of the Circuit Court of Appeals for the Second Circuit is not in conflict with the decisions of the Seventh and Third Circuits and of this court, and of the Court of Appeals of the State of New York, but on the contrary, is in strict conformity therewith.

The petitioners claim that the present decision of the Circuit Court is in conflict with the decisions of the Circuit Court of Appeals for the Seventh and Third Circuits, referring to *In Re Palisades-on-the-Desplaines,* 89 Fed. (2) 214 (C. C. A. 7); *In re Park Beach Hotel Bldg. Corp.,* 96 Fed. (2) 886 (C. C. A. 7); *Snyder* v. *Fenner,* 101 Fed. (2) 736 (C. C. A. 3).

There is no such conflict. The foregoing decisions were rendered before the enactment of the Chandler Act, and related to the construction of Section 77 B, subdivision A of the Bankruptcy Act, which provided that an answer of the debtor which admits the jurisdiction of the court, the material allegations of the petition, and consents to reorganization under that section, automatically converted the involuntary petition into a voluntary one, making it unnecessary to prove acts of bankruptcy on the part of the debtor.

The Circuit Court in the present decision (R. 721) states:

> "Chapter X did away altogether with the answer as a voluntary petition; Sec. 127 is all that remains of the earlier law and it merely allows the debtor to petition for reorganization either before or after adjudication. Thus it appears that, at least when the reorganization emerges from a liquidation, an answer can no longer serve as a petition; and, if so, it is incredible that it should retain that office when interposed in a reorganization proceeding itself."

There is no decision of the Circuit Court of Appeals for the Seventh Circuit or Third Circuit or any other

Circuit which is in conflict with the foregoing decision of the Circuit Court above quoted.

The petitioners also claim that the decision of the Circuit Court conflict with the decision of the Court of Appeals of the State of New York, in *People ex rel. Manice* v. *Powell*, 201 N. Y. 194, 200, 201.

The Circuit Court, in its opinion stated (R. 724):

> "Be that as it may, we need not too much regret it even if in this instance form may prevail, because, although directors, so long as they hold office and use an honest judgment, are immune from the control of their shareholders, *People ex rel. Manice* v. *Powell*, 201 N. Y. 194, 200, 201, the power to commit a corporation one day before they know they are to be displaced, to a course known to be disapproved by the majority is not one to be generously extended. Normally the shareholders should have their way."

The Circuit Court cites with approval the case of *People ex rel. Manice* v. *Powell*, 201 N. Y. 194. In the case at bar, the directors were accused of fraudulently filing an answer consenting to the involuntary petition, and of fraudulently preventing the majority stockholders from electing a new board of directors who could have legally filed an amended answer, if they had not been improperly enjoined from holding the annual meeting for the election of directors. The respondents do not question the fact that honest directors, who honestly hold office and use honest judgment, are immune from the control of stockholders. This was recognized by the Circuit Court, which specifically pointed out that in this particular case the charges of fraud and bad faith on the part of the old board of directors were sustained, the Circuit Court stating (R. 719) as follows:

> "On February 20, 1940, three creditors of the debtor filed a petition to reorganize it under Chapter X; the directors of the debtor probably knew in ad-

vance of this proceeding, and possibly they inspired it; at any rate on the 21st they met and passed a resolution that the debtor thereby declared its inability to pay its debts and consented that the petition should be approved and that the debtor should file (fol. 720) an answer to that effect. This it did on the 23rd, although all five directors would have gone out of office on the 24th, the day of the annual meeting of shareholders."

Nor is there any conflict between the foregoing decision of the Circuit Court and this Court's decision in *Royal Indemnity Co.* v. *American Bond & Mortgage Co.*, 289 U. S. 165. The record is replete with evidence showing that the old board of directors acted in bad faith and in fraud of the rights of stockholders (R. 507, 511, 512). The very fact that the debtor acting through its old Board of Directors filed an answer (R. 14) consenting to a reorganization which sought to eliminate the rights of all stockholders (R. 8) of a solvent company, is in itself a fraud and a clear violation of the fiduciary obligations which the directors owed to its stockholders.

Kavanaugh v. *Kavanaugh Knitting Co.*, 226 N. Y. 185, 193, 196;
Pollitz v. *Wabash R. R. Co.*, 207 N. Y. 113, 124.

The evidence is conclusive that the answer was filed on February 23rd, 1940, with full knowledge that the annual meeting of stockholders was to take place on February 24th, 1940, for the election of directors (R. 507, 512). Its purpose was to prevent the holding of this meeting, thereby depriving the stockholders of a vested property right to vote for directors of their own choice.

In re J. P. Linahan, Inc., 111 Fed. (2d) 590;
Lord v. *Equitable Life Assurance Society*, 194 N. Y. 212.

POINT II.

The original answer of the debtor did not convert the involuntary proceeding into a voluntary one so as to make it unnecessary for the petitioning creditors to prove insolvency or acts of bankruptcy.

(1) There is no statutory provision under Chapter X for the conversion of an involuntary petition for reorganization into a voluntary one as was formerly permitted under Section 77 B (a).

Section 18 b of the Bankruptcy Act, before its amendment by the Act of June 22, 1938, provides as follows:

> "The bankrupt, or any creditors, may appear and plead to the petition within 5 days after the return day, or within such further time as the court may allow."

After its amendment by the Chandler Act, it now provides as follows:

> "The bankrupt and, in the case of a petition against a partnership, any general partner or, in the case of a petition in behalf of a partnership, any general partner not joining therein, may appear and plead to the petition within five days after the return day or within such further time as the court may allow."

It will be noted, therefore, that the right which creditors previously had to file an answer to an ordinary involuntary petition in bankruptcy has now been abolished.

See:

Matter of National Republic Co., 109 Fed. (2nd) 167 (C. C. A. 7th, 1940).

Under former Section 77 B (a) of the Bankruptcy Act, 3 or more creditors who had provable claims which

amounted in the aggregate in excess of the value of the securities held by them to $1000 or over, or stockholders owning 5 per centum in number of all shares of stock of any class of the debtor, were given the right to file an answer to a petition or an answer of the debtor which sought reorganization under that section.

When Chapter X of the Chandler Act was enacted, the above restrictions were removed by Sec. 137 and the absolute and unrestricted right was given to any creditor, or if the debtor was not insolvent, to any stockholder, to file an answer to an involuntary petition for a reorganization. Section 137 provides as follows:

> "SEC. 137. ANSWER BY CREDITOR, INDENTURE TRUSTEE OR STOCKHOLDER; TIME LIMIT.—Prior to the first date set for the hearing provided in section 161 of this Act (Sec. 561 of this title), an answer controverting the allegations of a petition by or against a debtor may be filed by any creditor or indenture trustee or, if the debtor is not insolvent, by any stockholder of the debtor. (June 22, 1938, c. 575, Sec. 1, 52 Stat. 887.)"

In *Thomas K. Finletter's treatise on the Law of Bankruptcy Reorganization,* at page 647, it is stated:

> "An especially alert creditor thus has some opportunity to investigate the facts as to the debtor's solvency and to appeal from the order within the statutory period."

Section 144 of Chapter X provides for a determination of the issues raised by such an answer. This Section provides:

> "SEC. 144. DETERMINATION OF ISSUES RAISED BY CREDITORS', INDENTURE TRUSTEE'S OR STOCKHOLDER'S ANSWER.—If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of

> the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter (Secs. 501 to 676 of this title) and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied. (June 22, 1938, c. 575, Sec. 1, 52 Stat. 887.)"

It is therefore apparent that under Chapter X, an answer may be filed by a creditor or stockholder controverting the allegations of a petition by or against the debtor, in which event the issues thus raised must be determined by the court. There is no provision under Chapter X which provides that a determination of such issues can be dispensed with in any manner, shape or form. Nor is there any provision under Chapter X which provides that the filing of an answer by the debtor admitting the allegations of the petition and consenting to a reorganization, converts the involuntary proceeding into a voluntary one. Such provisions were previously expressly provided for in Section 77 B, subdivision (a), which in part contained the following provision:

> "If such answer shall admit (a) the jurisdiction of the court, and (b) the material allegations of the petition, the court shall enter an order approving the petition as properly filed under this section if satisfied that it complies with this section and has been filed in good faith, or dismiss it if not so satisfied. * * *; and if any such petition shall be so approved, the proceedings thereon shall continue with like effect as if the corporation had itself filed a petition or answer under this section."

When the corresponding Section 142 of Chapter X of the Chandler Act was enacted, the above provisions were eliminated. This section provides as follows:

> "SEC. 142. DEBTOR FAILING TO FILE ANSWER OR FILING INSUFFICIENT ANSWER.—If an answer is not filed by a debtor to a petition against it, or if the answer filed does not controvert any material allegations of the petition, the judge shall enter an order approving the petition if satisfied that it complies with the requirements of this chapter * * * and has been filed in good faith, or dismissing it if not so satisfied."

Prior to the enactment of the Chandler Act, a number of decisions construed Section 77B, subdivision (a) of the Bankruptcy Act to the effect that an answer of a debtor which admits the jurisdiction of the court, the material allegations of the petition and consents to reorganization under that section, automatically converts the involuntary proceeding into a voluntary one, making it unnecessary to prove acts of bankruptcy on the part of the debtor.

> *Matter of Park Beach Hotel Building Corp.*, 96 Fed. (2nd) 886 (7th Circuit);
> *Matter of Palisades-on the Desplaines, Debtor*, 89 Fed. (2nd) 214.

The fact that, when the corresponding Section 142 of the Chandler Act was enacted, the former provisions of Section 77B, subdivision (e) were not re-enacted, indicates that there was no intent on the part of Congress to convert an involuntary proceeding into a voluntary one by the answer of the debtor, particularly since creditors and stockholders, if debtor is solvent, are now given an unrestricted right to file answers to the petition.

In *In re Elmsford Country Club*, 50 Fed. (2nd) 238 (U. S. D. C., Southern District of New York, 1931), Judge Patterson, then sitting as District Judge, at page 239, said:

> "It has been decided in several cases that the filing of an answer by an alleged bankrupt asking that he be adjudged bankrupt, does not convert an involuntary proceeding into a voluntary one. *In re Supreme Lodge, supra.* See also, *in re Condon* (C. C. A.), 209 F. 800; *Central State Bank* v. *Harrington* (C. C. A.), 4 F. (2d) 514."

See also:

> *In re Supreme Lodge*, 286 Fed. Rep. 180;
> *In re L. Humbert Co.*, 100 Fed. 439, at p. 440;
> *Albers Commission Co.* v. *Richter*, 251 Fed. 869.

An involuntary proceeding can be converted into a voluntary one only by statute. As such former provisions which were included in Section 77 B (a) have now been eliminated by Section 142, it necessarily follows that it was incumbent on the petitioning creditors to prove that the debtor committed an act of bankruptcy within four months prior to the filing of the petition, particularly where, as in this case, the original answer was amended upon the trial so as to deny insolvency and acts of bankruptcy as alleged in petition (R. 493).

This proposition of law is very ably and thoroughly discussed in the opinion of the Circuit Court (R. 721-723).

Section 131 of the Bankruptcy Act, in part, provides as follows:

> "SEC. 131. CREDITORS' OR INDENTURE TRUSTEE'S PETITION; CONTENTS.—A creditors' or indenture trustee's petition shall, in addition to the allegations required by section 130 of this Act (Sec. 530 of this title), state—
>
> * * * * *

5. That the corporation has committed an act of bankruptcy within four months prior to the filing of the petition."

The burden of sustaining such proof was on the petitioning creditors.

In re Cook (C. C. A., 7th Cir.), 104 Fed. (2d) 981; *Shingleton* v. *Armour Boulevard Corporation,* 107 Fed. (2d) 440 (8th Cir.).

POINT III.

The proper administration of proceedings under Chapter X has in no way been impeded by the decision of the Circuit Court of Appeals, Second Circuit, but on the contrary, said decision promotes the proper administration of justice by preventing directors of a corporation from fraudulently filing a consent to a sham involuntary petition.

A FRAUD WAS PERPETRATED ON THE DISTRICT COURT BY THE PETITIONING CREDITORS BY THE FILING OF A PETITION THAT COULD NOT HAVE LEGALLY BEEN FILED IN THE FIRST INSTANCE. A FRAUDULENT FILING OF AN INVOLUNTARY PETITION CANNOT BE CURED BY ANY ANSWER OR OTHER ACTS OF THE DEBTOR.

The evidence indicated without contradiction that no act of bankruptcy was committed within four months prior to the filing of the petition (R. 414). At the time of the filing of the petition, the attorney for the petitioning creditors admitted that he knew of no act of bankruptcy (R. 513-4). The creditors were familiar with the financial set-up and transactions of the debtor and claimed that the debtor was perfectly solvent (R. 508). Notwithstanding these facts, the petitioning creditors, in their involuntary petition, alleged that the debtor was insolvent,

that the capital stock was worthless, and that an act of bankruptcy had been committed within four months next preceding the filing of the petition (R. 8). They could not legally file a petition unless they complied with Section 131, subdivision 5, by truthfully alleging that the corporation had committed an act of bankruptcy within four months prior to the filing of the petition. The allegation contained in the petition of the commission of an act of bankruptcy was false. Under such circumstances, a fraud was perpetrated. The filing of the answer by the debtor, acting through a hostile board of directors who had similar knowledge, aided and abetted the commission of a fraud on the district court. It would be against public policy to permit the petitioning creditors to gain a legal advantage by such fraudulent conduct.

The Circuit Court, in its opinion, said (R. 720):

> "It is indeed true, if we take the petition and answer together, that enough can be spelled out to satisfy the requirements of Sec. 130. The answer itself declares that the debtor is 'unable to pay its debts as they mature,' and not only consents to the approval of the petition, but prays that it should be approved; the other necessary facts it admits by not denying them. Rule 8 (d). Thus the debtor has expressly or impliedly made all the declarations that it need have made if it had filed a petition."

However, subsequent to the filing of this answer, the debtor, acting through its old board of directors, by and with the consent of the petitioning creditors amended its answer during the trial of the issues, so as to deny insolvency and the acts of bankruptcy alleged in the involuntary petition (p. 493). Under such circumstances, the petition and answer, as amended, taken together, do not spell out sufficient facts to satisfy the requirements of Section 130.

POINT IV.

The petitioners cannot question the applicability of Rule 15 (a) of the Federal Rules of Procedure, as no such question was raised by them in the court below.

For the first time, the petitioners claim that Rule 15 (a) of the Federal Rules of Civil Procedure does not apply to a Chapter X proceeding. It is too late to raise that point now, as no such objection was made in the court below.

Duignan v. *United States,* 274 U. S. 195, 200.

Furthermore, such claim is frivolous, as General Order in Bankruptcy No. 37 makes such rules applicable to all bankruptcy proceedings.

Rule 15A of the Federal Rules of Civil Procedure, relating to the filing of amended and supplemental pleadings, provides, in part:

> "* * * and leave shall be freely given when justice so requires."

The liberality in pleading and the free power of amendment as given by the new federal rules of civil procedure have been fully recognized by the various circuit courts. *Downey* v. *Palmer,* 114 Fed. (2d) 116 (Aug. 12, 1940). *Globe Paper Co.* v. *Travis Drug Co.,* 112 Fed. (2nd) 350 (6th Cir. June 7, 1940); *Shoreland Co.* v. *Conklin* (C. C. A. 5th Cir.) 30 Fed. (2d) 489, 490; *Kroell* v. *N. Y. Ambassador,* 108 Fed. (2nd) 294 (2nd Cir.).

In *Remington on Bankruptcy,* 4th Ed., Volume 1, it is stated, at pages 489-490:

> "SEC. 383. AMENDMENT OF ANSWER.—Amendment of the answer may be allowed, and it may be error to refuse amendment in a proper case; as for example, where officers of a corporation, negligent in their

duties, or adverse in interest, or in collision with the petitioning creditors, have answered, the court may allow stockholders to intervene, and to amend the answer, and to make defense."

POINT V.

It is not the policy of this court to grant a writ of certiorari to review conflicting evidence.

The opinion of the Circuit Court is based on conflicting evidence presented before the District Court which was up for review. Its decision reversing the order of confirmation of the Special Master's report, and granting in its discretion permission to the debtor to file an amended answer, is based on the evidence which was reviewed by the Circuit Court.

Under such circumstances, this court has held that it will not grant a writ to review conflicting evidence.

United States vs. *Johnston*, 268 U. S. 220, 227.

POINT VI.

The order sought to be reviewed is interlocutory only, and not a final order, and presents no question of law of public or exceptional importance.

The petitioners have failed to show any gravity or any question of general importance or any conflict in the various decisions of the Circuit Courts which would warrant the granting of a writ of certiorari, which is only granted by this Court in extraordinary and exceptional cases.

Denver v. *N. Y. Trust Co.*, 229 U. S. 123;
American Const. Co. v. *Jacksonville Ry. Co.*, 148 U. S. 372, 384;
Magnun Co. v. *Coty*, 262 U. S. 159, 163.

POINT VII.

The petition for a writ of certiorari should in all respects be denied, with costs.

Respectfully submitted,

WEINSTEIN & LEVINSON,
Attorneys for Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, answering majority stockholders, and Agatha L. Moore, answering creditor, Respondents.

BAAR, BENNETT & FULLEN,
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FRANK WEINSTEIN,
SAMUEL J. LEVINSON,
JOHN P. HURLEY,
of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 84

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN,

Petitioners,

against

AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act,

Respondents.

RESPONDENTS' REPLY BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

WEINSTEIN & LEVINSON,
Attorneys for Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, answering majority stockholders, and Agatha L. Moore, answering creditor, Respondents.

BAAR, BENNETT & FULLEN,
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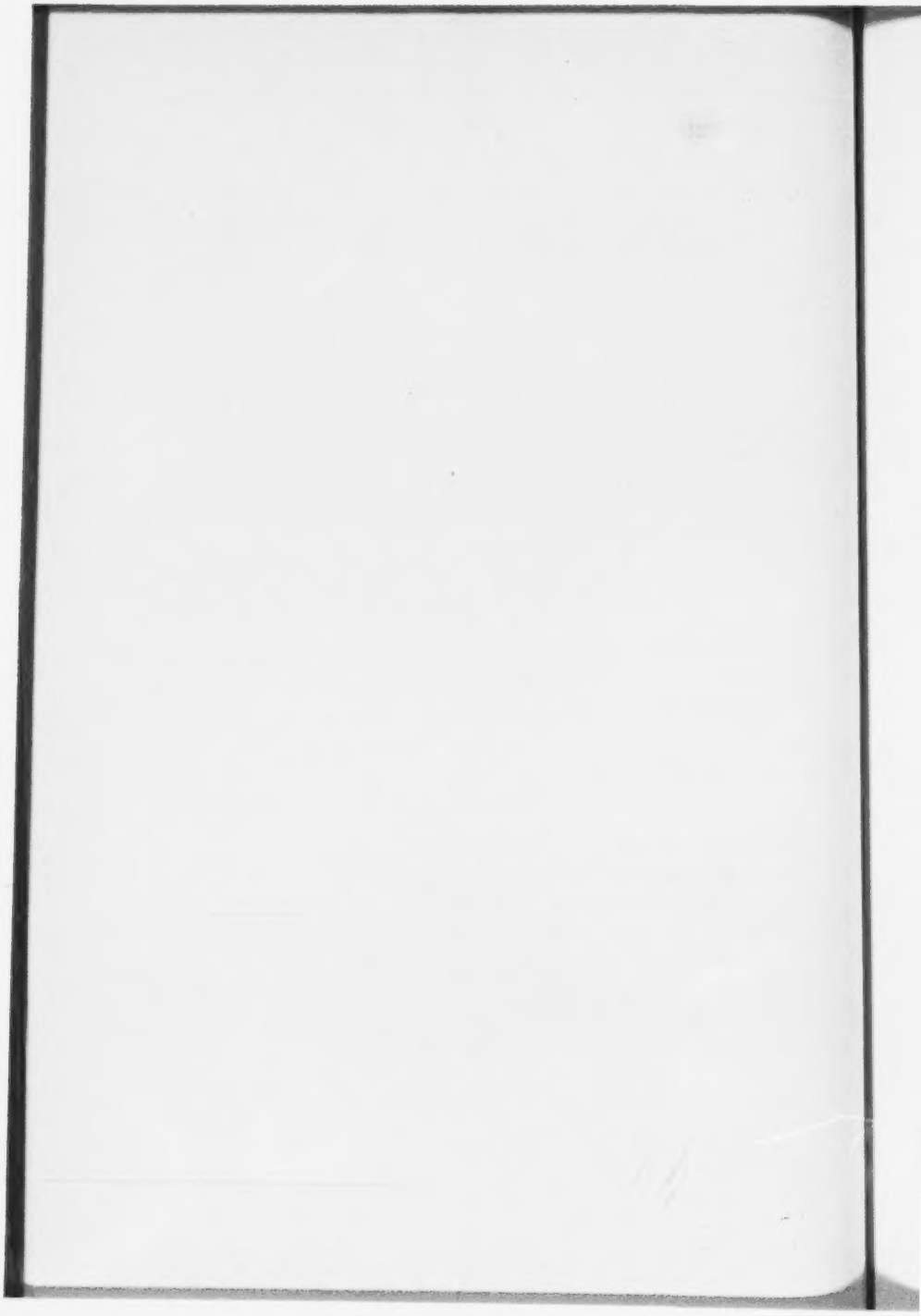

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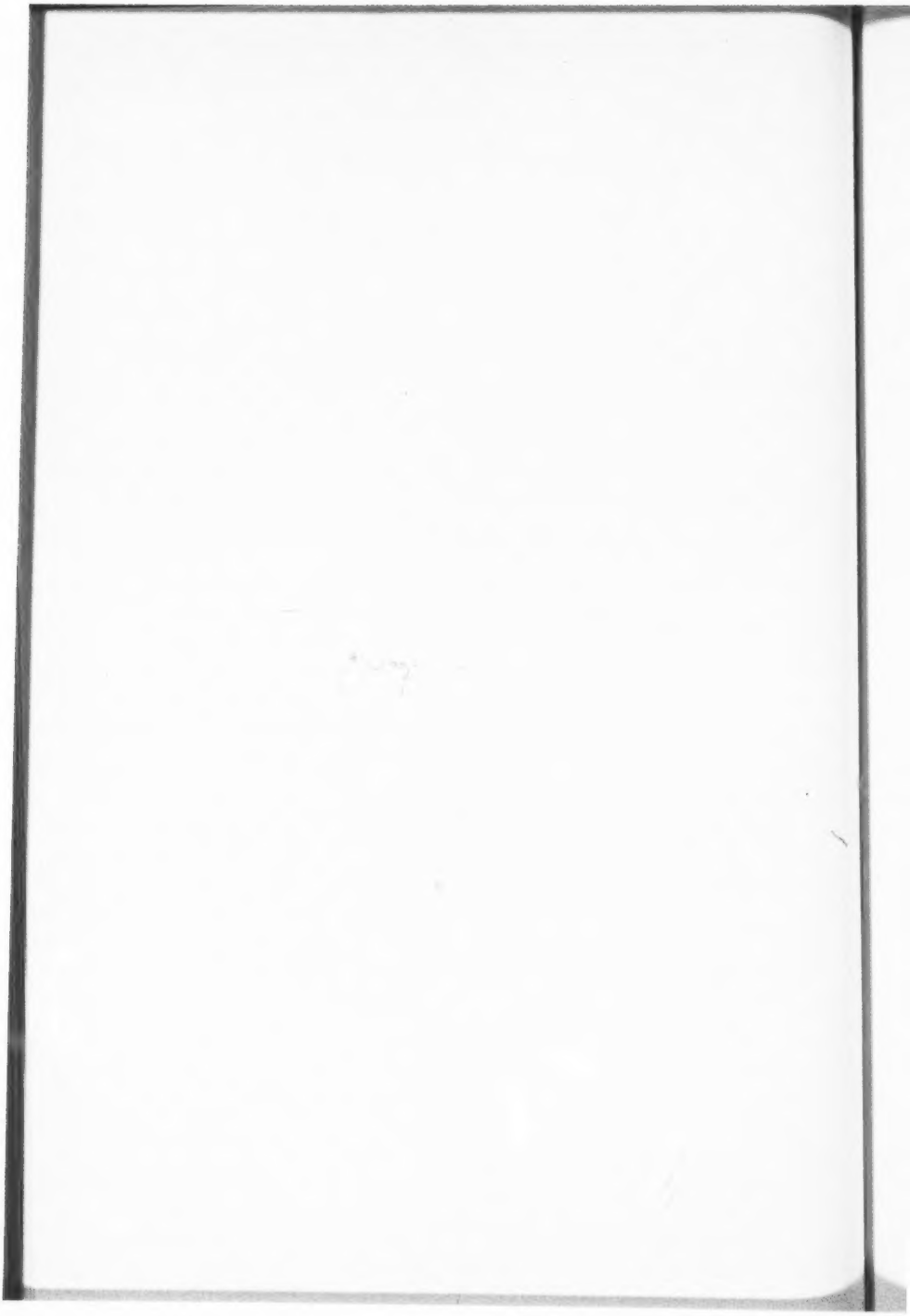

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN, Petitioners, against AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act, Respondents.	No.

RESPONDENTS' REPLY BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

Petitioners' reply brief contains inaccurate statements, and untenable and misleading contentions.

On page 2, petitioners state that

> "* * * the Circuit Court made it clear in its opinion, that it felt constrained to permit the withdrawal of the debtor's answer as a matter of right, although recognizing that such a holding resulted in a subordination of substance to form (Tr. 724")."

This statement is without warrant. The learned Circuit Court reversed the order confirming the Referee's report

approving the Chapter X reorganization petition, and granted leave to the debtor to file a new answer, so that the debtor may controvert the allegations of the petition (particularly the alleged commission of an act of bankruptcy) and seek dismissal of the petition. The learned Circuit Court rejected the untenable and technical contentions of the petitioners that the court lacked power to permit the debtor to withdraw its original answer and to contest Chapter X reorganization. The court below recognized that substantial justice plainly required that the new board of directors be permitted to undo the fraud of the old board in collusively consenting, on their very last day in office, to a Chapter X reorganzation that sought to eliminate the substantial equity of the stockholders of an amply solvent corporation, with full knowledge that the majority stockholders intended, on the next day, to elect new directors opposed to any reorganization under Chapter X that sought elimination of the equity of the stockholders and in favor of a fair arrangement under Chapter XI. The court below also recognized that the original fraud of the old board was accentuated by the subsequent illegal attempt of the petitioners to prevent any undoing of the fraud. For the petitioners applied for and procured from the reorganization court an injunction which permanently restrained the election of new directors and thereby prevented the election of a new board who, under Rule 15 (a) of the Federal Rules of Civil Procedure, would have had an absolute right to amend the debtor's answer so as to contest the petition and controvert its allegations. The injunction was reversed on appeal by the Circuit Court (*In re J. P. Linahan & Co.*, 111 F. 2nd 590). The fraud of the old board and their collusion with the petitioners (including the minority stockholder, Anna Louise Linahan, who has in bad faith instigated and used this Chapter X proceeding in an effort to force settlement of outside litigation and

controversies between herself and the majority stockholders, and whose counsel, Mr. H. I. Trachman, has acted as chief counsel for the petitioners in all of the proceedings herein), are so apparent that the Circuit Court writes that "the directors of the debtor probably knew in advance of this proceeding, and possibly they inspired it", and further writes:

> "Be that as it may, we need not too much regret it even if in this instance form may prevail, because, although directors, so long as they hold office and use an honest judgment, are immune from the control of their shareholders, *People ex rel. Manice* v. *Powell*, 201 N. Y. 194, 200, 201, 94 N. E. 634, the power to commit a corporation one day before they knew they are to be displaced, to a course known to be disapproved by the majority is not one to be generously extended. Normally the shareholders should have their way."

The reference made by the learned court below to form and substance, was not that, in this case, form prevailed over substance, but that the construction of Section 59, subdivision (g) of the Bankruptcy Act urged herein by the petitioners might lead to such a result. The court below noted that, even if the petitioners' contention, that Section 59, subdivision (g) precludes withdrawal of a debtor's answer without notice to all creditors, were to be assumed correct, such notice would not have permitted any creditor to object to withdrawal of the answer, since no creditor was prejudiced by reliance on the answer. The learned Circuit Court cites the decision of the Circuit Court of Appeals, Seventh Circuit, in the case of *In re Thorpe*, 12 F. 2nd 775, as holding that the right to withdraw a petition can be defeated only by proof that a creditor has relied on the petition to his detriment. But, as

the court below also notes, a rule contrary to that enunciated in the *Thorpe* case appears to have been followed in several District Court decisions (*In re Sullivan*, 23 F. Supp. 112; *In re Epstein*, 12 F. Supp. 450; *In re Browne*, 30 F. Supp. 157), in which, apparently, reliance and detriment were not deemed essential to denial of leave to withdraw a debtor's petition. It is only if the decision of the District Courts, rather than that of the Circuit Court in the *Thorpe* case, be followed, and if Section 59, subdivision (g), be construed as permitting a creditor to defeat withdrawal of a debtor's petition, even though no prejudice has resulted to the creditor, that the possibility of form yielding to substance might exist, since Section 59, subdivision (g), by its express terms, applies only to a debtor's petition, and not to a debtor's answer. Restricting the right to withdraw a debtor's petition without similarly restricting the right to withdraw a debtor's answer, furnishes no basis for reading the restriction into the answer, where the statute expressly and unambiguously limits the restriction to a petition. Section 59, subdivision (g), clearly applies only to a petition, and not to an answer.

On page 2, petitioners refer to the fact that the Circuit Court dismissed as moot respondents' appeal from the District Court's order of July 5, 1940, and argue that such dismissal indicates that the Circuit Court granted leave to the debtor to file a new answer, not as a matter of discretion, but as a matter of absolute right. But the appeal from the order of July 5, 1940, was made moot because the order confirming the Referee's report approving the petition for reorganization was reversed and leave was granted to the debtor to file a new answer, and the case was sent back to the District Court for retrial upon the new issues to be raised by the new answer. The granting of leave to file such new answer rested in sound judicial discretion, and was necessary in order to pre-

vent the gross fraud upon the majority stockholders that the petitioners (particularly the minority stockholder) were seeking to perpetrate.

In the last two paragraphs on page 2 of their reply brief, petitioners refer to their objection in the courts below to the filing of a new answer. But the petitioners, in the lower courts, made no claim that Rule 15 (a) does not apply to bankruptcy or reorganizations. Such claim is made by them now in this Court for the first time.

As to the mootness of the petitioners' present resistance to the new answer, the debtor has in fact served and filed a new answer which specifically denies the alleged commission of an act of bankruptcy and which demands dismissal of the Chapter X petition. The proceedings relating to such new issues have been adjourned by the Referee upon the motion of the petitioners and over the vigorous objection of the respondents.

The statement on page 3 of petitioners' reply brief that Sections 24A, 24B and 24C of the Bankruptcy Act permit an appeal from the order here involved as a matter of right, is palpably unsound. The order now under consideration is not final, but is interlocutory. It is an order which reverses the order approving the reorganization petition, and remits the entire matter for retrial upon new issues to be raised by the new answer.

The comment from 18 N. Y. U. Law Quarterly Review, page 410, quoted on pages 4 to 6 of the petitioners' reply brief, does not criticize the decision of the Circuit Court herein. The suggesion is there made that, in this case, leave could have been granted to the debtor to withdraw its original answer and to file a new answer, and that it was not necessary to determine whether, in the absence of withdrawal, a debtor's answer consenting to Chapter X reorganization permits either the corporation or creditors or stockholders to raise any issue as to the commission of an alleged act of bankruptcy. The writer of the comment states at page 411:

> "It is not at all clear, however, that adherence to the 77B cases would have demanded the conclusion that a consenting answer is so exact an equivalent of a voluntary petition as to prevent a withdrawal of the answer except upon terms applicable to petitions."

Indeed, the writer concedes:

> "But other issues—such as insolvency, need for reorganization, or good faith—must naturally remain open to attack by any party in interest as a protection against proceedings collusively or fraudulently instituted."

The debtor's amended answer, among other things, raises these very issues of insolvency, need for reorganization, and good faith, "as a protection against proceedings collusively or fraudulently instituted".

Respectfully submitted,

WEINSTEIN & LEVINSON,
Attorneys for Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, answering majority stockholders, and Agatha L. Moore, answering creditor, Respondents.

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